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Supreme Court of the United States

OCTOBER TERM, 1961

No. 87

MANAGED FUNDS, INCORPORATED,
PETITIONER,

vs.

J. JOHN BROUK, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED MAY 6, 1961
CERTIORARI GRANTED JUNE 19, 1961

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

IN UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MISSOURI

EASTERN DIVISION

Civil Action No. 59 C 162 (3)

MANAGED FUNDS, INCORPORATED, a corporation, Plaintiff,

vs.

SLAYTON ASSOCIATES, INC., a corporation, SLAYTON & COMPANY, INC., a corporation, MUTUAL FUND DISTRIBUTORS, INC., a corporation, HILTON H. SLAYTON, HOVEY E. SLAYTON, JAMES S. STUBBS, HAROLD W. SMITH and LEO MODEL, ROLF R. ROLAND, FRITS MARKUS, ROBERT ROSENBERG, WALTER H. BERTON, WALTER S. MORRIS, ERWIN WOLFF, STEPHEN M. JAQUITH, ELLIOTT D. FOX, FRANK L. THOMPSON and HERMAN H. STONE, each individually and as a member of a co-partnership, doing business under the name of MODEL, ROLAND & STONE, and JACOB BAKER, LLOYD E. BOAS, J. JOHN BROUK, CHARLES E. BROWN, EDWIN J. CUNNINGHAM, ROBERT A. HICKS, JOHN C. JESTER, JAMES J. MULLEN, JR., JEFFERSON J. REBSTOCK, EARL R. RICE, W. MUNRO ROBERTS, JR., and GEORGE H. SHIELDS, III, Defendants.

AMENDED COMPLAINT IN NO. 59 CIVIL 162 (3)—
Filed October 23, 1959

Count I.

Comes now the plaintiff, and as and for its first claim for relief against the defendants, and each of them, states as follows:

1. This action arises under and by reason of the defendants' violation of the Investment Company Act of 1940, [fol. 2] 54 Stat., Sections 789-847, 15 U. S. C. 80a, and the rules promulgated by the Securities and Exchange Commission thereunder.

2. The plaintiff is a corporation, registered under the Investment Company Act of 1940 and engaged in the sale of shares of its stock to the general public through underwriters, distributors, dealers and salesmen.

3. The defendant Slayton Associates, Inc., is a corporation principally engaged in serving as an investment adviser and manager of investments.

4. The defendants Slayton & Company, Inc., and Mutual Fund Distributors, Inc., are corporations each engaged in business as registered brokers or dealers in investment securities.

5. The defendants Hilton H. Slayton and Hovey E. Slayton were at all times mentioned herein until May 3rd, 1959, the principal managers, officers and directors of the plaintiff, were also at all such times the sole stockholders, principal officers and directors of defendant Slayton Associates, Inc., and also the principal and controlling stockholders, principal officers and directors of the defendants Slayton & Company, Inc., and Mutual Fund Distributors, Inc.

6. The defendant Jacob Baker was a director of the plaintiff from a date prior to the year 1952 up to and including the 21st day of October, 1955; defendant Lloyd E. Boas was a director of the plaintiff from November 23, 1954, to and including June 12, 1959; defendant J. John Brouk on June 28, 1955, became a director of the plaintiff, and ever since has been and now is a director of plaintiff; defendant Charles E. Brown was a director of the plaintiff from November 27, 1953, to and including May 3, 1954; defendant Edwin J. Cunningham was a director of the plaintiff from a date prior to the year 1952 up to and including June 28, 1955; defendant Robert A. Hicks was a director of the plaintiff from November 18, 1957, to and including May 3, 1959; defendant John C. Jester was a director of the plaintiff from June 23, 1952, to and including November 27, 1953; defendant James J. Mullen, Jr., on May 21, 1954, became a director of the plaintiff, and ever since has been and now is a director of [fol. 3] plaintiff; defendant Jefferson J. Rebstock, on June 23, 1952, became a director of the plaintiff, and ever since

has been and now is a director of plaintiff; defendant Earl R. Rice was a director of the plaintiff from a date prior to the year 1952, and ever since has been and now is a director of plaintiff; defendant W. Munro Roberts, Jr., on June 28, 1955, became a director of the plaintiff, and ever since has been and now is a director of plaintiff; defendant George H. Shields, III, was a director of the plaintiff from June 23, 1952, to and including November 23, 1954; and all of the defendants hereinabove in this paragraph named are, for convenience, sometimes hereinafter referred to as the "outside directors". On information and belief, the said outside directors, and each of them, had either actual knowledge of the acts hereinafter complained of, or, in the performance of the duties and obligations imposed upon them by law as directors, and by the exercise of ordinary care and diligence in the performance of such duties and obligations, would have acquired knowledge of such acts, and hence are chargeable with having constructive knowledge thereof.

7. The defendants, Leo Model, Rolf R. Roland, Frits Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Erwin Wolff, Stephen M. Jaquith, Elliott D. Fox, Frank L. Thompson and Herman H. Stone are members of a co-partnership, doing business as Model, Roland & Stone, and said partnership is principally engaged as a registered broker-dealer, and member of the New York Stock Exchange, in the sale or purchase of securities.

8. The defendant Stephen M. Jaquith is a partner in the partnership of Model, Roland & Stone, and was at all times mentioned herein either an employee of or partner in said partnership.

9. The defendant James S. Stubbs is an employee and representative of the partnership of Model, Roland & Stone, and a former business associate of the defendants Hilton H. Slayton and Hovey E. Slayton and former director of the plaintiff.

10. The defendant Harold W. Smith is an employee and representative of the partnership of Model, Roland & Stone, and is a brother-in-law of defendant Hovey E. Slayton.

[fol. 4] 11. All of the defendants herein had actual or constructive knowledge of the provisions of the Investment Company Act of 1940, and the rules promulgated by the Securities and Exchange Commission thereunder.

12. In accordance with the Investment Company Act of 1940, and the said applicable rules, plaintiff's announced and published policy in offering its shares, of all series, for sale has been that plaintiff's primary purpose is to provide for capital growth, and that to the extent consistent with such policy plaintiff would seek reasonable income on its investments, which net investment income and any realized profits on the sale of securities in its portfolio would be distributed quarterly. Statements of this policy were contained in the reports and prospectuses required to be filed with the Securities and Exchange Commission under the Investment Company Act of 1940, and the prospectuses required to be filed under the Securities Act of 1933 and distributed to the public in connection with the sale of plaintiff's shares.

13. In accordance with the provisions of the Investment Company Act of 1940, and the said rules thereunder, plaintiff was required to file certain annual and quarterly reports, and to therein truthfully state certain information with reference to the affairs and operations of plaintiff, and such information as is required must consist of true statements of material facts, and said law further requires that there be no omission to state in such reports facts necessary in order to prevent the statements which are made from being materially misleading.

14. The defendant Slayton Associates, Inc., by contract dated August 15, 1952, was employed by plaintiff as an investment adviser, and by such contract said defendant was obligated to furnish plaintiff with such advisory, research and statistical service with reference to investments as were in accordance with plaintiff's policies, and in return therefor said defendant was paid an annual fee in the amount of one-half of one per cent (½ of 1%) of the total asset value of plaintiff's assets.

15. On December 1, 1953, defendant Slayton Associates, Inc., entered into a contract with defendant Jaquith [fol. 5] whereby defendant Jaquith was employed as investment counsellor and manager of the securities portfolio of plaintiff, and thereafter defendant Slayton Associates, Inc., while still receiving a fee for such services pursuant to its contract with plaintiff, unlawfully delegated its duties thereunder to defendant Jaquith and abdicated its duties and responsibilities under said contract. By provisions of said contract between the defendant Slayton Associates, Inc., and defendant Jaquith it was agreed that the defendant Jaquith, or such person, persons or firms as he might designate, would be paid, beginning December 1, 1953, the annual sum of $50,000.00 for five years, and be paid for the succeeding five years a minimum of $35,000.00, said minimum payments to apply against brokerage commissions which defendant Slayton Associates, Inc., would direct to defendant Jaquith or his designees.

16. Pursuant to the contract mentioned in the preceding paragraph the defendant Jaquith designated the partnership of Model, Roland & Stone as the recipient of the commissions mentioned therein, and the defendants Hilton H. Slayton, Hovey E. Slayton and Slayton Associates, Inc. thereupon directed plaintiff's brokerage business to the defendant Jaquith and Model, Roland & Stone, for which they have received brokerage commissions in excess of $1,500,000.00.

17. The defendant Jaquith and Model, Roland & Stone, at the direction of defendant Slayton Associates, Inc., paid annual commissions to each of the defendants Smith and Stubbs in excess of $50,000.00 per year, no services having been performed by either of said defendants in return for such payments.

18. After advisory service was furnished by defendant Jaquith and Model, Roland & Stone pursuant to the contract between defendant Slayton Associates, Inc. and defendant Jaquith, plaintiff's basic policy of "capital growth" was not followed, but, on the contrary, a policy was fol-

lowed in handling the portfolio of plaintiff, which would maintain a predetermined amount of distributions on plaintiff's shares from year to year, and if the income from the portfolio investments was not sufficient therefor to realize [fol. 6] gains for such distribution from the sale of plaintiff's securities, and the policy followed permitted the underwriters of said securities, the defendants Slayton & Company, Inc., and Mutual Fund Distributors, Inc., to make greater sales of plaintiff's shares and thereby obtain greater commissions and profits.

19. The policy followed, as set forth in the preceding paragraph, resulted in gross mismanagement of, and loss and damage to, the investment portfolio of plaintiff, and greatly increased the brokerage commissions for the purchase and sale of the portfolio securities of plaintiff, and resulted in greater payments under the contracts between the defendants Slayton Associates, Inc. and Jaquith, all without a corresponding or any benefit to plaintiff.

20. Plaintiff was caused to place reciprocal brokerage business on transactions in plaintiff's portfolio securities with broker-dealers who sold plaintiff's shares, to place such brokerage business with securities firms who supplied, without cost, certain publications and communication facilities to defendants Slayton & Company, Inc., Mutual Fund Distributors, Inc. and Slayton Associates, Inc., and to satisfy obligations for merchandise and services rendered to defendants Slayton & Company, Inc., Mutual Fund Distributors, Inc. and Slayton Associates, Inc., by directing to the suppliers thereof such brokerage business.

21. Plaintiff further states, on information and belief, that the defendants committed, or with actual or constructive knowledge, as hereinabove set forth, aided, abetted, acquiesced in or condoned, directly or indirectly, violations of the Investment Company Act of 1940, in that, inter alia,

(a) the plaintiff was operated, managed, and its portfolio securities were selected, in the interest of directors, officers, investment advisers, and other af-

filiated persons thereof, and in the interest of underwriters, brokers and dealers, rather than in the interest of all classes of plaintiff's securityholders;

(b) the plaintiff was caused to publish, circulate and file with the Securities and Exchange Commission [fol. 7] required registration statements, amendments thereto, reports and prospectuses, which documents contained untrue statements of material facts or omitted to state material facts required to be stated therein or necessary to make the statements therein not misleading;

(c) the plaintiff was caused to deviate from a fundamental policy recited in its registration statement pursuant to Section 8 (b) (2) of the Act, without being authorized to do so by the vote of a majority of its outstanding voting securities; and

(d) defendants Leo Model, Rolf R. Roland, Frits Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Erwin Wolff, Stephen M. Jaquith, Elliott D. Fox, Frank L. Thompson and Herman H. Stone, as members of a co-partnership doing business under the name of Model, Roland & Stone, and Stephen M. Jaquith, individually, served or acted as investment advisers of the plaintiff, without a written contract approved by the vote of a majority of the outstanding voting securities of plaintiff.

22. By reason of the aforesaid violations of the Investment Company Act of 1940 by the defendants it has been necessary for plaintiff to stop the sale of its shares until such time as it can strictly comply with said Act, and the rules thereunder; that its good name and good will, and competitive position have been thereby injured.

23. By reason of all of the foregoing acts plaintiff is entitled to recover the damages it has sustained thereby and the profits thereby made by the defendants; that plaintiff is unable to state, without a full accounting, the amount of said damages and profits, and that an accounting should be had herein.

Wherefore, plaintiff prays judgment against all of the defendants, adjudging them jointly and severally liable to plaintiff, and that an accounting be ordered and judgment rendered thereon in favor of plaintiff for its damages, including the unlawful profits received by defendants, and for such other relief as to the Court may seem meet and proper.

[fol. 8] Count II.

Comes now the plaintiff and as and for its second claim for relief against defendants, and each of them, states as follows:

1. This Court has jurisdiction of this claim for relief by reason of the fact that it, and the grounds therefor, arise out of the same acts, occurrences and transactions as those set forth and complained of in Count I of this Amended Complaint wherein this Court has jurisdiction as set forth in Paragraph 1 of said Count I.

2. The allegations of Paragraphs 2 through 20 of Count I are here incorporated by reference as though set forth in haec verba in this Count II of this Amended Complaint.

3. By reason of the acts and things hereinabove set forth, plaintiff was caused to file similar registration statements, prospectuses and reports under the Securities Act of 1933, as amended, and may be liable in actions under such Act to persons, if any, injured and thereby damaged. In addition, the Securities and Exchange Commission, by reason thereof, instituted stop order proceedings In the Matter of Managed Funds, Incorporated, File No. 2-11061 under the Securities Act of 1933, Section 8 (d), in which proceedings, after lengthy hearings, the Commission, on July 30, 1959, issued its findings and opinion and stop order whereby plaintiff's good name, good will, and competitive position have been greatly injured and damaged, and plaintiff has been caused to expend large sums of money for counsel fees and other expenses in connection with such stop order proceedings, and any matters incident thereto.

4. By reason of all of the foregoing acts plaintiff is entitled to recover damages it has sustained thereby, and to the profits thereby made by the defendants; that plaintiff is unable to state without a full accounting the amount of said damage and profits, and that an accounting should be had herein.

Wherefore, plaintiff prays judgment against all of the defendants adjudging them jointly and severally liable to plaintiff, and that an accounting be ordered and judgment [fol. 9] rendered thereon in favor of plaintiff for its damages, including the unlawful profits received by defendants, and for such other relief as to the Court may seem meet and proper.

Count III.

Comes now the plaintiff and as and for its third claim for relief against defendants, and each of them, states as follows:

1. This Court has jurisdiction of this claim for relief by reason of the fact that it, and the grounds therefor, arise out of the same acts, occurrences and transactions as those set forth in Count I of this Amended Complaint where in this Court has jurisdiction as set forth in Paragraph 1 of said Count I.

2. The allegations of Paragraphs 2 through 20 of Count I are here incorporated by reference as though set forth in haec verba in this Count III of this Amended Complaint.

3. Defendants Hilton H. Slayton and Hovey E. Slayton, as directors and President and Vice-President, respectively, of plaintiff, were acting in a fiduciary capacity with respect to plaintiff, and owed to plaintiff the duty of undivided loyalty in the operation of plaintiff and in the management of its affairs; defendants Leo Model, Rolf R. Roland, Frits Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Erwin Wolff, Stephen M. Jaquith, Elliott D. Fox, Frank L. Thompson and Herman H. Stone, as members of a co-partnership doing business under the name of Model, Roland & Stone, and Stephen M. Jaquith, individually, were acting as investment advisers of the

plaintiff, and hence in a fiduciary capacity with respect to the plaintiff, and owed to plaintiff the duties and obligations of fiduciaries; and each of the other defendants had actual knowledge of the relationship of defendants Hilton H. Slayton and Hovey E. Slayton to plaintiff, and actual or constructive knowledge of the relationship of said members of the co-partnership of Model, Roland & Stone, and of Stephen M. Jaquith, to plaintiff.

4. By reason of the unlawful and wrongful acts hereinabove set forth, defendants Hilton H. Slayton and Hovey E. Slayton wholly disregarded and breached their duties [fol. 10] and obligations as officers, directors, trustees and fiduciaries of the plaintiff, and, at the expense of and to the damage of plaintiff, mismanaged the affairs of plaintiff, caused plaintiff to make payment of fees and commissions to the defendants Slayton Associates, Inc., Mutual Fund Distributors, Inc., Slayton & Company, Inc., the members of the co-partnership of Model, Roland & Stone, Stephen M. Jaquith, James S. Stubbs and Harold W. Smith, committing waste to the property and assets of the plaintiff, all to the profit of said defendants and of the other defendants except the said outside directors.

5. By reason of the unlawful and wrongful acts hereinabove set forth, the defendants Leo Model, Rolf H. Roland, Frits Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Erwin Wolff, Stephen M. Jaquith, Elliott D. Fox, Frank L. Thompson and Herman H. Stone, as members of the co-partnership doing business under the name of Model, Roland & Stone, and the defendant Stephen M. Jaquith, individually, wholly disregarded and breached their duties as fiduciaries of the plaintiff, and participated in, aided, abetted, condoned and acquiesced in said mismanagement of the affairs of the plaintiff at the expense of and to the damage of plaintiff, and to their own great profit.

6. All of the defendants had actual knowledge of the fact of the relationship of defendants Hilton H. Slayton and Hovey E. Slayton to plaintiff; all of the defendants had actual or constructive knowledge of the relationship of the said defendants Leo Model, Rolf R. Roland, Frits

Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Erwin Wolff, Stephen M. Jaquith, Elliott D. Fox, Frank L. Thompson and Herman H. Stone, as members of the co-partnership doing business under the name of Model, Roland & Stone, and defendant Stephen M. Jaquith; and hence all defendants are chargeable with and liable for the said acts.

7. By reason of all of the foregoing acts plaintiff is entitled to recover the damages it has sustained and to the profits thereby wrongfully made by certain of the defendants; plaintiff is unable to state, without a full accounting, the amount of said damages and profits, and an accounting should be had herein.

[fol. 11] Wherefore, plaintiff prays judgment against all the defendants, adjudging them jointly and severally liable to plaintiff, and that an accounting be ordered and judgment rendered thereon in favor of plaintiff for its damages, including the wrongful profits received by defendants, and for such other relief as to the Court may seem meet and proper.

Count IV.

Comes now the plaintiff and as and for its fourth claim for relief against the defendants, and each of them, states as follows:

1. The allegations of Paragraphs 2 through 20 of Count I and Paragraphs 3 through 6 of Count III of this Amended Complaint are here incorporated by reference as though set out at length here in this Count IV of this Amended Complaint.

2. All of said defendants' acts were unlawful and wrongfully committed as a part of, and pursuant to, an unlawful agreement and conspiracy between all of said defendants, except said outside directors, for the purpose of unlawfully making use of the business and funds of plaintiff, to the plaintiff's damage and to the great profit of the said defendants; and said outside directors, as hereinabove set forth, had either actual or constructive knowledge of, did nothing to prevent the consummation of, and are hence

chargeable with liability for, such unlawful agreement and conspiracy.

3. By reason of the foregoing acts and conspiracy plaintiff is entitled to recover the damages it has sustained and to the profits thereby made by the defendants; plaintiff is unable to state, without a full accounting, the amount of such damages and profits; and an accounting should be had herein.

Wherefore, plaintiff prays judgment against all of the defendants, adjudging them jointly and severally liable to plaintiff, and that an accounting be ordered and judgment rendered thereon in favor of plaintiff for its damages, including the wrongful profits received by defendants, [fol. 12] and for such other relief as to the Court may seem meet and proper.

R. H. McRoberts, Gaylord C. Burke, Marion S. Francis, 1630 Boatmen's Bank Building, St. Louis 2, Missouri.

Bryan, Cave, McPheeters & McRoberts, Of Counsel.

[fol. 12]

IN UNITED STATES DISTRICT COURT

DISTRICT OF DELAWARE

Civil Action No. 2100

EMANUEL JOSEPHSON, Plaintiff,

—against—

HILTON H. SLAYTON, HOVEY E. SLAYTON, JR., STEPHEN M. JAQUITH, HOWARD W. SMITH, JAMES S. STUBBS, a Partnership of "JOHN" MODEL, "JAMES" ROLAND and "JACK" STONE, First Names Being Fictitious and Unknown, Doing Business Under the Trade Name of MODEL, ROLAND AND STONE, EARL R. RICE, LLOYD E. BOAS, JEFFERSON J. REBSTOCK, JAMES J. MULLEN, JR., JOHN BROUK, ROBERT A. HICKS, W. MUNRO ROBERTS, JR., SLAYTON ASSOCIATES, INC., SLAYTON & COMPANY, INC., MUTUAL FUND DISTRIBUTORS, INC., AND MANAGED FUNDS, INCORPORATED, Defendants.

COMPLAINT IN No. 59 CIVIL 279 (3)—
Filed May 12, 1959

(Transferred from U. S. District Court,
District of Delaware.)

Plaintiff, above named, by his attorney, as and for his bill of complaint shows and alleges, upon information [fol. 13] and belief, except as to paragraphs marked "First" and "Second", which are alleged upon knowledge:

First: That plaintiff has continuously been and now is the owner of shares of stock of Managed Funds Incorporated (referred to as "MF") and more particularly was a shareholder of MF at the times of the transactions of which he complains and which are now continuing.

Second: That this is a derivative action brought by the plaintiff in the right of and for the benefit of MF.

Third: That the jurisdiction of this action arises by virtue of the defendants' violations of the Investment Company Act of 1940, and its rules (U. S. Code, Title 15, Section 80a, et seq.) and the Investment Advisers Act of 1940 and its rules (U. S. Code, Title 15, Section 80b, et seq.).

Fourth: That MF is a Delaware corporation, principally engaged and registered as a publicly held open-end investment company under the Investment Company Act of 1940.

Fifth: That Slayton Associates, Inc. (referred to as "SA"), is a Delaware corporation principally engaged and registered as an investment adviser under the Investment Advisers Act of 1940.

Sixth: That all times hereinafter mentioned, Hovey E. Slayton, Jr., and Hilton H. Slayton were the sole stockholders, principal officers and directors of SA.

Seventh: That Howard W. Smith is the brother-in-law of Hovey E. Slayton and has served as his alter ego.

Eighth: That Edward W. Smith, together with his wife Virginia Slayton Smith, are voting trustees with Hovey E.

Slayton, Jr., in the voting of the largest block and controlling shares of Slayton & Company, Inc., a registered broker-dealer principally engaged in the distribution of MF shares to the general public.

Ninth: That James S. Stubbs is a former business associate of Hilton H. Slayton and a former director of MF.

[fol. 14] Tenth: That at all times hereinafter mentioned, there existed a close business relationship between Smith, Stubbs and the Slaytons.

Eleventh: That at all times hereinafter mentioned, the individuals, Slayton, Slayton, Jr., Rice, Boas, Rebstock, Mullen, Jr., Brouk, Hicks and Roberts, Jr., were the directors of MF.

Twelfth: That at all times hereinafter mentioned, Hilton H. Slayton and Hovey E. Slayton, Jr., were respectively the president and executive vice-president of MF and constituted its principal operating heads and persons in working control of MF.

Thirteenth: That at all times hereinafter mentioned, the partnership and trade name of Model, Roland and Stone, consisting of partners "John" Model, "James" Roland and "Jack" Stone, the true first names being unknown and fictitious, engaged in the sale and purchase of securities as members of the New York Stock Exchange.

Fourteenth: That at all times hereinafter mentioned, Stephen M. Jaquith was principally engaged as an investment adviser and associated with Model, Roland & Stone.

Fifteenth: That in accordance with the applicable regulations of the Investment Company Act, MF offered its shares for sale upon the expressed policy that it will be the principal and primary purpose of MF to provide for "capital growth" on all series and to the extent consistent with the foregoing policy MF will seek reasonable income on its investments, which net investment income and any realized profits from the sale of portfolio securities would be distributed quarterly.

Sixteenth: That commencing with August 15, 1952 and continuing to the date of the commencement of this action,

SA has been employed by MF as investment adviser pursuant to successive written contracts, which among other provisions, represented that SA was able and had the know-how to render the specific and general services of investment adviser.

[fol. 15] Seventeenth: That by reason of the agreement of August 15, 1952 now in effect between MF and SA, SA was obligated to and undertook to furnish advisory, research and statistical services required by MF's investment policies.

Eighteenth: That since December 1, 1953 and continuing up to the present, MF has paid to SA in excess of $1,000,000.00 for the investment services allegedly rendered under the terms of the contract.

Nineteenth: That the agreement of August 15, 1952 between MF and SA was not assignable and did not authorize abdication or delegation of the advisory services to or by any substitute representative and in any event would be illegal.

Twentieth: That commencing with December 1, 1953 and continuing to date, Stephen J. Jaquith became and assumed the activities of an investment adviser for MF by reason of an agreement made between Jaquith and SA which in essence required Jaquith, then an employee of Model, Roland and Stone, under the general direction and approval of SA to use his best judgment in the selection, purchase and sale of securities under the general policy of SA as it would be determined from time to time and that SA in payment for the services to be rendered, agreed to direct brokerage commission business to Jaquith or to such persons or firms as he might designate for a 5 year period in a total minimum amount of $250,000 in commissions, payable at $50,000 per annum minimum and for a second five year period in a total minimum of $175,000 at $35,000 per year minimum.

Twenty-First: That at all the times hereinafter mentioned and commencing with December 1, 1953, Model, Roland and Stone, Jaquith, Smith and Stubbs shared and participated in the division of commissions exceeding a

total of $1,600,000 that SA had directed MF to give to Model, Roland & Stone, pursuant to the designation and direction of Jaquith.

Twenty-Second: That since December 1, 1953, and continuing to the present, while Jaquith served as investment [fol. 16] adviser to MF, the published principal and primary policy of MF of "capital growth" was illegally changed so as to maintain a predetermined amount of distributions on MF's shares from year to year and when the investment income was not adequate to provide for such distributions, to realize gains on sales of portfolio securities in order to maintain the distributions at the desired rate, without the approval of the stockholders of MF and illegal under the applicable law.

Twenty-Third: That since December 1, 1953 and continuing to the present, the acts of the defendants have violated the primary and principal policy of "capital growth" on all series of MF's shares.

Twenty-Fourth: That in 1958 and as an instance, the ratio of turnover of the portfolio securities has been 98% of the fund as compared with a 20% average in the trade.

Twenty-Fifth: That the illegal agreement between Jaquith and SA was never approved by the stockholders of MF, within the provisions of the Investment Company Act.

Twenty-Sixth: That despite the performance of the investment advisory service rendered by Jaquith, SA continued to receive and accept compensation in excess of $1,000,000 from MF for services that it did not perform.

Twenty-Seventh: That since December 1, 1953, and continuing to date, MF utilized realized capital gains under equalization credits and such equalization accounts were reflected under the caption Net Investment Income in the statement of net assets for each of the published financial annual and semi-annual reports ending November 30, 1954-1958, thereby rendering such reports false and misleading.

Twenty-Eighth: That at all times hereinafter mentioned, Slayton & Company, Inc. (referred to as "Slayco") and

Mutual Fund Distributors, Inc. (referred to as "Mutual") are Missouri corporations, principally engaged as broker-dealer underwriters for the sale and distribution of MF shares.

[fol. 17] Twenty-Ninth: That at all the times hereinafter mentioned, the principal and controlling stockholders, officers and directors of Slayco and Mutual were Hilton H. Slayton and Hovey E. Slayton, Jr. (also operating through a voting trust agreement with Virginia and Howard W. Smith (sister and brother-in-law of Slayton)).

Thirtieth: That since 1952 and continuing to date, MF at the instance and direction of Hilton H. Slayton and Hovey E. Slayton, Jr., gave all of the MF underwritings for the sale of its shares to Slayco and Mutual at the fixed and unaltered rate of commission of 9.89% of the net asset value of the shares without seriously and reasonably seeking out competitive underwriters at lesser rates and failing to properly adjust downwards the existing selling charges.

Thirty-First: That since 1952 and continuing to date Slayco and Mutual have rendered nominal services by reason of their channelling all the underwriting of MF shares through others, which has resulted in tremendous net commissions of about 2½% of the aggregate, as a gift to Slayco and Mutual.

Thirty-Second: That since 1952 and continuing to date, Slayco and Mutual have benefited to the extent of at least $500,000 in excessive and unnecessary commissions.

Thirty-Third: That since 1954 and continuing to date, Hilton H. Slayton and Hovey E. Slayton, Jr., have received compensation aggregating in excess of $100,000 for services rendered as officers of MF, when in fact, no services were rendered.

Thirty-Fourth: That the defendants in the instances and at the times mentioned committed, aided, abetted, acquiesced and condoned, directly and indirectly, the violations by MF of the provisions of the Investment Company Act of 1940 and the Investment Advisers Act and the rules applicable thereto, by:

(a) omitting material facts required to be stated.

(b) filing reports containing untrue statements of material facts.

[fol. 18] (c) omitting to state facts necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading, by doing

as follows:

(1) Omitted to state in the reports of MF that since December 1, 1953, Jaquith had become an investment adviser of MF by reason of the contract of December 1, 1953, between SA and Jaquith; the terms of compensation to Jaquith through Model, Roland & Stone.

(2) Omitted to state in the reports of MF that SA was obligated to furnish advisory services to MF under its contract of August 15, 1952, and that SA's agreement with Jaquith constituted an abdication and delegation to Jaquith of SA's duties.

(3) Omitted to state that Jaquith was employed by Model, Roland & Stone, stockbrokers; that SA had not performed the services required of it for which it had received payment; that SA directed commissions to Jaquith through Model, Roland & Stone in excess of $1,600,000 at the instance of Jaquith to be shared between Jaquith, Smith (Slayton's brother-in-law) Model, Roland & Stone and Stubbs (an associate of Slayton) in exchange for the investment advisory services; that such agreements and participation was in violation of law and was therefore illegal.

(4) Omitted to state that the agreement of December 1, 1953, between SA and Jaquith was illegal; that payments were made to persons Smith, Stubbs and Jaquith because of illegal agreements; that the payments made to SA were illegal and without consideration.

(5) Omitted to state that MF changed its basic policy of "capital growth"; that the MF financial

statements for realized gains, were improperly included in equalization credits and that such equalization accounts were reflected under the caption Net Investment Income in the statement of net assets; that the financial statements of MF without any explanatory [fol. 19] note were misleading and false in contravention to law.

(6) Omitted to state that MF was granting a preference with excessive and wasteful charges for commissions and compensation to SA, Slayco and Mutual because of the relationship and interests of the respective controlling persons.

(7) Omitted to state that the salaries paid to the Slaytons were gratuities, wasteful and unnecessary under the circumstances then prevailing.

(8) Omitted to state that the greatest single beneficiary of MF is Hilton H. Slayton and Hovey E. Slayton, Jr., by reason of payments made to them through their alter egos.

Thirty-Fifth: That the wrongful acts herein described, have been and continue to be committed by the defendants against MF in breach of legal and fiduciary obligations that are inherent by reason of the relationship of the parties.

Thirty-Sixth: That plaintiff has made no demand upon MF or its directors to institute this suit, inasmuch as such a demand would be futile and unavailing for the reason that the directors of MF have approved, acquiesced in, ratified, committed and are committing the very wrongful, wilful and illegal acts complained of herein, and the said directors are serving with the approval of, domination and control of the Slaytons and are beholden and completely subservient to their wishes, direction and control, with the result that a demand upon said defendants to bring an action on behalf of MF and against the remaining defendants would be tantamount to requesting them to prosecute a suit against themselves and such demand would in any event be futile and unavailing.

Thirty-Sixth: (sic) That plaintiff has not consented to, ratified nor acquiesced in the activities and misconduct of the defendants, as aforesaid, which activities were conceived and perpetrated without the knowledge of the plaintiff, but were in fact, carefully concealed from plaintiff and the other stockholders and the Securities and Exchange [fol. 20] Commission; that the plaintiff did not become aware of the illegal acts herein until April, 1959.

Thirty-Seventh: That plaintiff has no adequate remedy at law.

Thirty-Eighth: That the defendants be enjoined from continuing the illegal acts and be held to account for the losses, damages and illegal payments for the benefit of MF.

Wherefore, plaintiff demands judgment against all the defendants for

(a) Accounting (except MF).

(b) Injunction.

(c) Damages (excepf MF).

(d) Other relief as this Court may deem necessary, and reasonable counsel and accounting fees, together with the disbursements and costs of this action.

Cohen and Morris, By Irving Morris, Attorney for Plaintiff, 300 North American Bldg., Wilmington, Delaware.

Of Counsel: Louis H. O. Fischman, Esquire, 276 Fifth Avenue, New York City, New York.

Duly sworn to by Emanuel Josephson (jurat omitted in printing).

[fol. 21]

In United States District Court for the

Eastern District of Missouri

Eastern Division

Civil Action No. 59 C 162 (3)

Managed Funds, Incorporated, a Corporation, Plaintiff,

vs.

Slayton Associates, Inc., a Corporation et al., Defendants.

Joint Motion of Defendants J. John Brouk et al., to Dismiss in No. 59 Civil 162 (3)—Filed January 4, 1960

Defendants, J. John Brouk, W. Munro Roberts, Jr. and James J. Mullen, Jr., jointly move the Court to dismiss Counts I, II, III, IV of plaintiff's amended complaint for lack of jurisdiction over the subject matter in that plaintiff bases jurisdiction respecting Counts I to III, inclusive, of the claim averred in said Counts upon alleged violations of the Investment Company Act of 1940, Title 15 U. S. C. A., Section 80a et seq., and that said Act does not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in Counts I, II, and III of plaintiff's amended complaint either expressly or by implication; that Count IV of plaintiff's amended complaint fails to aver any basis whatsoever for jurisdiction of this Court respecting such Count, and that each of Counts I, II, III and IV fail to aver a cause of action [fol. 22] within the jurisdiction of this Court against these defendants arising under the Constitution laws and treaties of the United States, and fail to present a Federal question respecting which this Court has jurisdiction.

Defendant requests oral argument on this motion.

Forrest M. Hemker, Attorney for Defendants, J. John Brouk, W. Munro Roberts, Jr., and James J. Mullen, Jr.

Greensfelder, Hemker & Wiese, Suite 1212, 705 Olive Street, St. Louis 1, Missouri, Chestnut 1-9090.

In United States District Court

Motion of Defendant Jefferson J. Rebstock to Dismiss in No. 59 Civil 162 (3)—Filed December 4, 1959

Defendant, Jefferson J. Rebstock, a citizen and resident of the State of Louisiana, appearing specially and solely for the purpose of this motion and for no other purpose, moves the Court as follows:

1. To dismiss Counts I, II and III of plaintiff's amended complaint for lack of jurisdiction over the subject matter in that plaintiff bases jurisdiction respecting Counts I to III, inclusive, of the claims averred in said Counts upon alleged violations of the Investment Company Act of 1940, Title 15, U. S. C. A., Section 80a et seq., and that said Act does not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in Counts I, II and III of plaintiff's amended complaint either expressly or by implication.

2. To dismiss Counts I, II, III and IV of plaintiff's amended complaint for lack of jurisdiction of the person of this defendant and to quash the return of service of summons on this defendant on the ground that he is a citizen and resident of the State of Louisiana as appears from affidavit attached hereto and is not subject to service [fol. 23] of process outside of the State of Missouri under any of the claims averred in Counts I, II, III and IV of plaintiff's amended complaint for the reason that no statute of the United States provides for service beyond the territorial limits of Missouri respecting said claims and under Federal Rule 4(f) process may be served only within the territorial limits of the State of Missouri, and for the further reason that Count IV of plaintiff's amended complaint fails to aver any grounds of jurisdiction of this Court.

3. Defendant requests oral argument on this motion.

Forrest M. Hemker, Attorney for Defendant, Jefferson J. Rebstock.

Greensfelder, Hemker & Wiese.

In United States District Court

Motion of Defendant Earl R. Rice to Dismiss in No. 59 Civil 162 (3)—Filed December 28, 1959

Defendant, Earl R. Rice, a citizen and resident of the State of Florida, appearing specially and solely for the purpose of this motion and for no other purpose, moves the Court as follows:

1. To dismiss Counts I, II and III of plaintiff's amended complaint for lack of jurisdiction over the subject matter in that plaintiff bases jurisdiction respecting Counts I to III, inclusive, of the claim averred in said Counts upon alleged violations of the Investment Company Act of 1940, Title 15, U. S. C. A., Section 8a et seq., and that said Act does not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in Counts I, II and III of plaintiff's amended complaint either expressly or by implication.

2. To dismiss Counts I, II, III and IV of plaintiff's amended complaint for lack of jurisdiction of the person [fol. 24] of this defendant and to quash the return of service of summons on this defendant on the ground that he is a citizen and resident of the State of Florida as appears from affidavit attached hereto and is not subject to service of process outside of the State of Missouri under any of the claims averred in Counts I, II, III and IV of plaintiff's amended complaint for the reason that no statute of the United States provides for service beyond the territorial limits of Missouri respecting said claims and under Federal Rule 4(f) process may be served only within the territorial limits of the State of Missouri, and for the further reason that Count IV of plaintiff's amended complaint fails to aver any grounds of jurisdiction of this Court.

3. Defendant requests oral argument on this motion.

Forrest M. Hemker, Attorney for Defendant, Earl R. Rice.

Greensfelder, Hemker & Wiese.

In United States District Court for the
Eastern District of Missouri
Eastern Division
No. 59-C-279 (3)

Emanuel Josephson, Plaintiff,

vs.

Hilton H. Slayton, et al., Defendants.

Supplementary Motion of Defendant Jefferson J. Rebstock to Dismiss Complaint in No. 59 Civil 279 (3)—Filed April 19, 1960

Defendant, Jefferson J. Rebstock, a citizen and resident of the State of Louisiana, appearing specially and solely for the purpose of this motion and for no other purpose, [fol. 25] files this motion as a supplementary motion to this defendant's motion to dismiss heretofore filed, and moves the Court as follows:

1. To dismiss plaintiff Emanuel Josephson's complaint for the reasons set out in this defendant's motion heretofore filed herein.

2. To dismiss plaintiff Emanuel Josephson's complaint for lack of jurisdiction of the person of this defendant, and to quash the return of service of summons on this defendant on the ground that he is a citizen and resident of the State of Louisiana, and is not subject to service of process outside of the State of Delaware, or after transfer to this Court outside of the State of Missouri under any of the claims averred in plaintiff's complaint for the reason that no statute of the United States provides for service beyond the territorial limits of Delaware or Missouri respecting said claims, and under Federal Rule 4 (f) process may be served only within the territorial limits of the State of Missouri.

3. To dismiss Emanuel Josephson's complaint for lack of jurisdiction over the subject matter in that plaintiff bases jurisdiction of the claim averred upon alleged violations of the Investment Company Act of 1940 Title 15 U. S. C. A. Section 80a et seq., and the rules promulgated by the Securities and Exchange Commission thereunder, and that said Act and rules do not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in his complaint either expressly or by implication, and for the further reason that the complaint fails to aver any basis whatsoever for or within jurisdiction of this Court arising under the Constitution, laws and treaties of the United States, and fails to present a Federal question respecting which this Court has jurisdiction.

Forrest M. Hemker, Attorney for Defendant, Jefferson J. Rebstock.

Greensfelder, Hemker & Wiese.

[fol. 26]

IN UNITED STATES DISTRICT COURT

SUPPLEMENTARY MOTION OF DEFENDANT EARL R. RICE TO DISMISS COMPLAINT IN NO. 59 CIVIL 279 (3)—Filed April 19, 1960

Defendant, Earl R. Rice, a citizen and resident of the State of Florida, appearing specially and solely for the purpose of this motion and for no other purpose, files this motion as a supplementary motion to this defendant's motion to dismiss heretofore filed, and moves the Court as follows:

1. To dismiss plaintiff Emanuel Josephson's complaint for the reasons set out in this defendant's motion heretofore filed herein.

2. To dismiss plaintiff Emanuel Josephson's complaint for lack of jurisdiction of the person of this defendant, and to quash the return of service of summons on this defendant on the ground that he is a citizen and resident of the State of Florida, and is not subject to service of process

outside of the State of Delaware, or after transfer to this Court outside of the State of Missouri under any of the claims averred in plaintiff's complaint for the reason that no statute of the United States provides for service beyond the territorial limits of Delaware or Missouri respecting said claims, and under Federal Rule 4 (f) process may be served only within the territorial limits of the State of Missouri.

3. To dismiss Emanuel Josephson's complaint for lack of jurisdiction over the subject matter in that plaintiff bases jurisdiction of the claim averred upon alleged violations of the Investment Company Act of 1940, Title 15, U. S. C. A., Section 80a et seq., and the rules promulgated by the Securities and Exchange Commission thereunder, and that said Act and rules do not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in his complaint either expressly or by implication, and for the further reason that the complaint fails to aver any basis whatsoever for or within jurisdiction of this Court arising under the Constitution, laws and treaties [fol. 27] of the United States, and fails to present a Federal question respecting which this Court has jurisdiction.

Forrest M. Hemker, Attorney for Defendant, Earl R. Rice.

Greensfelder, Hemker & Wiese.

IN UNITED STATES DISTRICT COURT

SUPPLEMENTARY MOTION OF DEFENDANTS W. MUNRO ROBERTS, JR. ET AL., TO DISMISS COMPLAINT IN NO. 59 CIVIL 279 (3)—Filed April 19, 1960

Defendants, W. Munro Roberts, Jr., James J. Mullen, Jr., and J. John Brouk, are citizens and residents of the State of Missouri, appearing specially and solely for the purpose of this motion and for no other purpose, file this motion as a supplementary motion to these defendants' motion to dismiss heretofore filed, and move the Court as follows:

1. To dismiss plaintiff Emanuel Josephson's complaint for the reasons set out in the motion of these defendants heretofore filed herein.

2. To dismiss plaintiff Emanuel Josephson's complaint for lack of jurisdiction of the person of these defendants, and to quash the return of service of summons on these defendants on the ground that they are citizens and residents of the State of Missouri, and are not subject to service of process outside the State of Delaware under any of the claims averred in plaintiff's complaint for the reason that no statute of the United States provides for service beyond the territorial limits of Delaware and the transfer of this cause to this Court from the District Court of Delaware does not validate the process issued by the District Court of Delaware served outside of the State of Delaware.

[fol. 28] 3. To dismiss Emanuel Josephson's complaint for lack of jurisdiction of the subject matter in that plaintiff bases jurisdiction of the claim averred upon alleged violations of the Investment Company Act of 1940, Title 15, U. S. C. A., Section 80a et seq., and the rules promulgated by the Securities and Exchange Commission thereunder, and that said Act and rules do not confer jurisdiction on this Court of the claims attempted to be averred by plaintiff in his complaint either expressly or by implication, and for the further reason that the complaint fails to aver any basis whatsoever for or within the jurisdiction of this Court arising under the Constitution, laws and treaties of the United States, and fails to present a Federal question respecting which this Court has jurisdiction.

Forrest M. Hemker, Attorney for Defendants, W. Munro Roberts, Jr., James J. Mullen, Jr., and J. John Brouk.

Greensfelder, Hemker & Wiese.

IN UNITED STATES DISTRICT COURT

STATEMENT OF FILING OF MOTIONS SIMILAR TO MOTIONS OF RICE, REBSTOCK, BROUK, ROBERTS AND MULLEN

As reflected in the following Order dated July 1, 1960 of the United States District Court, Honorable Randolph H. Weber, Judge, motions similar to the motions of appellants, Rice, Rebstock, Brouk, Roberts and Mullen, were filed by other defendants-appellants, all of which motions were overruled in said Order.

[fol. 29]

IN UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF MISSOURI

EASTERN DIVISION

No. 59 C 162 (3)

MANAGED FUNDS, INC., Plaintiff,

vs.

SLAYTON ASSOCIATES, a Corporation, et al., Defendants.

No. 59 C 279 (3)

EMANUEL JOSEPHSON, Plaintiff,

PROTECTIVE CASUALTY INS. CO., Intervenor-Plaintiff,

vs.

HILTON H. SLAYTON, ET AL., Defendants.

ORDER OF DISTRICT COURT OVERRULING MOTIONS TO DISMISS—July 1, 1960

Various motions are pending in the above causes, which have been consolidated, memorandums and briefs have been filed therein, and in some instances hearings held thereon, and the Court now being fully advised does Order as follows:

1. In Cause No. 59 C 162:

A. Separate Motion of defendant Robert A. Hicks to Dismiss is overruled.

B. Motion of defendant Charles E. Brown to Dismiss is overruled.

C. Joint Motion of defendants Brouk, Roberts and Mullen to Dismiss is overruled.

D. Motion to Dismiss of defendant Earl R. Rice is overruled.

E. Motion to Dismiss of defendant Edwin J. Cunningham is overruled.

[fol. 30] F. Motion of defendant Jacob Baker to Dismiss is overruled.

G. Motion of defendant Jefferson J. Rebstock to Dismiss is overruled.

H. Motion of defendant George H. Shields, III, to Dismiss is overruled.

2. In Cause No. 59 C 279:

A. Defendant Managed Funds' Motion to Dismiss is overruled.

B. Defendants Rice, Boas, Rebstock, Mullen, Brouk and Roberts' Joint Motion to Dismiss, and the Supplemental Motion of defendants Roberts, Mullen and Brouk to Dismiss and the separate Supplemental Motions to Dismiss by defendants Rebstock and Rice are each and all separately overruled.

C. Joint Motion of defendants Slaytons, and Slayton Associates, Inc., to Dismiss, for Summary Judgment, to Dismiss for Failure to State a Claim, and Make More Definite and Certain are each and all hereby overruled.

D. Motion to Dismiss by defendant Hicks is overruled.

E. Motions of defendants, Slaytons, Slayton Associates, Slayton and Company, Inc., and Mutual Fund Distributors, Inc., to Dismiss or Enter Judgment of Dismissal, to

Strike, to Make More Definite and Certain and to State Separate Claims are each and all overruled.

F. Motion of defendants Boas, Rebstock, Rice, Mullen, Brouk and Roberts to Strike affidavit of plaintiff's counsel is overruled.

G. Motions for Protective Order and to Dismiss of defendants Model, Roland and Stone, Jaquith, Smith and Stubbs are overruled.

H. Motion of defendants Roberts, Mullen and Brouk to Dismiss Supplemental Complaint of Intervenor and Quash Service and Separate Motions of Defendants Rebstock and [fol. 31] Rice to Dismiss Supplemental Complaint of Intervenor and Quash Service are each and all overruled.

3. The Motions to Dismiss aforesaid were based upon the proposition that the Court does not have jurisdiction in that it is contended that the Investment Company Act does not provide for suits by individuals or corporations and therefore there is no federal question involved and the long-arm provisions for service do not apply.

Therefore, the Court's Order overruling the Motions to Dismiss, being otherwise non-appealable, and the Court being of the opinion that its Order on the Motions to Dismiss for lack of jurisdictions of the subject matter of the action and of the person of certain defendants, involves a controlling question of law upon which there is substantial ground for difference of opinion and that an immediate appeal from the Court's Order may materially advance the ultimate termination of the litigation, it is

Further Ordered that all parties affected by the Court's Order herein may make application for appeal under the provisions of § 1292 (b), Title 28, U. S. C., and if so, and if appeal is permitted, the proceedings herein are stayed until further order.

Done this 1st day of July, 1960.

Randolph H Weber, United States District Judge.

In United States District Court

Notice of Appeal of J. John Brouk et al. in Nos. 59 Civil 162 (3) and 279 (3)—Filed August 9, 1960

Notice is hereby given that J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, defendants herein, hereby appeal to the United States Court of Appeals for the Eighth Circuit from sections 1 and 2 of the Order entered in these consolidated causes on July 1, 1960 by Honorable Randolph [fol. 32] H. Weber, United States District Judge for the Eastern District of Missouri, a copy of which Order is attached hereto and identified as "Exhibit A."

Greensfelder, Hemker & Wiese, Attorneys for J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, By Mark R. Gale, Suite 1212—705 Olive Street, St. Louis 1, Missouri, Chestnut 1-9090.

In order to avoid duplication, "Exhibit A" referred to in the Notice of Appeal, being the Order of Honorable Randolph Weber, United States District Judge, overruling the motions of the appellants, and other motions, in these consolidated causes is not attached, since such order is already included in the record on preceding pages.

In United States District Court

Designation of Record on Appeal of J. John Brouk et al., in Nos. 59 Civil 162 (3) and 279 (3)—Filed August 23, 1960

Pursuant to Rule 75 (a) of the Federal Rules of Civil Procedure and Rule 8 (b) of the United States Court of Appeals of the Eighth Circuit, the above named appellants hereby designate the following portion of the above to be contained in the record on appeal in the above entitled consolidated actions to the United States Court of Appeals for the Eighth Circuit:

1. The amended complaint of Managed Funds, Inc., Plaintiff, vs. Slayton Associates et al., Defendants, in Cause No. 59 C 162 (3).

2. Complaint of Emanuel Josephson, Plaintiff, vs. Hilton H. Slayton et al., in Cause No. 59 C 279 (3).

[fol. 33] 3. Docket entry of Jan. 29, 1960 showing adoption by intervenor, Protective Casualty Ins. Co., of complaint referred to in paragraph 2 above as its complaint.

4. Joint motion of appellants, J. John Brouk, W. Munro Roberts, Jr. and James J. Mullen, Jr., to dismiss the amended complaint of Managed Funds, Incorporated for lack of jurisdiction of the subject matter in Cause No. 59 C 162 (3), filed January 4, 1960.

5. Motion of appellant, Jefferson J. Rebstock, to dismiss the amended complaint of Managed Funds, Inc. for lack of jurisdiction of the subject matter and of the person, in Cause No. 59 C 162 (3), filed December 7, 1959.

6. Motion of appellant, Earl R. Rice, to dismiss the amended complaint of Managed Funds, Inc. for lack of jurisdiction of the subject matter and of the person in Cause No. 59 C 162 (3), filed December 28, 1959.

7. Supplementary motion of appellants, Jefferson J. Rebstock and Earl R. Rice, to dismiss the complaint of Emanuel Josephson for lack of jurisdiction of the subject matter and person, and supplementary motion of appellants, J. John Brouk, James J. Mullen, Jr. and W. Munro Roberts, Jr., to dismiss said complaint on the lack of jurisdiction of the subject matter and of their person in Cause No. 59 C 279 (3), filed April 19, 1960.

8. Docket entry in Cause No. 59 C 279 (3) reflecting filing of similar motions against intervenor, Protective Casualty Insurance Company's complaint by adoption, namely the Josephson complaint.

9. Docket entries in Cause No. 59 C 162 (3) reflecting the filing of motions to dismiss the complaint of Managed Funds, Inc. by appellants Edwin J. Cunningham the 28th day of December, 1959, Jacob Baker the 8th day of December, 1959, George H. Shields III the 3rd day of December,

1959, Charles E. Brown the 8th day of January, 1960 and Robert A. Hicks the 11th day of January, 1960.

10. The Order of Honorable Randolph Weber, United States District Judge, filed July 1, 1960, overruling all of the aforesaid motions, and other motions, in these consolidated causes.

[fol. 34] 11. Notice of Appeal filed August 9, 1960.

12. Statement of points upon which appellants intend to rely on appeal (a concise statement of the points upon which appellants intend to rely on appeal is appended to this designation).

13. Proof of service of this designation and the statement of points upon which appellants intend to rely.

(Appellants reserve the right to designate further or other portions of the record and proceedings to be contained in the record on appeal, if such procedure be deemed necessary by reason of the filing by appellees of any counter designation on any objections to this designation.)

Greensfelder, Hemker & Wiese, by Forrest M. Hemker, Attorneys for Appellants, J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, 705 Olive Street, St. Louis 1, Missouri, Chestnut 1-9090.

IN UNITED STATES DISTRICT COURT

STATEMENT OF POINTS UPON WHICH APPELLANTS J. JOHN BROUK ET AL., INTEND TO RELY ON APPEAL IN NOS. 59 CIVIL 162 (3) AND 279 (3)—Filed August 23, 1960

The above named appellants state that the points upon which they intend to rely on this appeal are as follows:

1. The District Court erred in overruling appellants' motions filed in these consolidated causes to dismiss the complaint of Managed Funds, Inc., Cause No. 59 C 162 (3)

and Emanuel Josephson, No. 59 C 279 (3), and as adopted by intervenor, Protective Casualty Insurance Company as and for its complaint, on the ground of lack of jurisdiction of the subject matter and of the person of appellants for the following reasons:

[fol. 35] (a) Federal jurisdiction is claimed and averred to exist solely by virtue of alleged violations of the Investment Company and Advisers Company Act of 1940, 15 U. S. C. A. 80a and 80b, which act, however, does not create any federally protected rights, either expressly or by implication, giving rise to a cause of action of which the Federal Courts have jurisdiction, derivative or otherwise, by a registered investment company against its officers and directors, and alleged outsiders acting in concert with them alleged to have violated the act.

(b) The complaints therefore fail to state a case arising under the laws of the United States, and the District Court of the United States was without jurisdiction of the subject matter of the action attempted to be averred by both complaints.

2. Absent jurisdiction of the subject matter, the "long arm" service provisions (80a-43) of the Act are inapplicable, and jurisdiction cannot be obtained by service out of the District on non-resident defendants.

Greensfelder, Hemker & Wiese, By Forrest M. Hemker, Attorneys for Appellants J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, Suite 1212 —705 Olive Street, St. Louis 1, Missouri, Chestnut 1-9090.

IN UNITED STATES DISTRICT COURT

CERTIFICATE OF SERVICE OF DESIGNATION AND STATEMENT OF POINTS ON APPEAL IN NOS. 59 CIVIL 162 (3) AND 279 (3) —Filed August 23, 1960

Forrest M. Hemker, of lawful age, being duly sworn on his oath, states that he caused to be mailed a copy of the

attached Designation of Record on Appeal of J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jeffer-
[fol. 36] son J. Rebstock and Earl R. Rice to the United States Court of Appeals for the Eighth Circuit, and a copy of Statement of Points upon Which Appellants J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice Intend to Rely on Appeal to all of the attorneys of record in the above entitled consolidated cause on the ..... day of ....., 1960:

R. Walston Chubb, F. A. Maxeiner, Robert S. Allen and Lewis, Rice, Tucker, Allen and Chubb, 1555 Railway Exchange Building, 611 Olive Street, St. Louis 1, Missouri, Attorneys of record for plaintiff, Managed Funds, Inc.

Lon Hocker and Hocker, Goodwin & MacGreevy, 411 N. Seventh Street, St. Louis 1, Missouri, Attorneys of record for defendants, Slayton Associates, Inc., Slayton & Company, Inc., Mutual Fund Distributors, Inc., Hilton Slayton and Hovey E. Slayton.

Richmond C. Coburn and Coburn & Croft, 411 North Seventh Street, St. Louis 1, Missouri, Attorneys of record for defendants, Harold W. Smith and Model, Roland & Stone, a co-partnership.

Cobbs, Armstrong, Teasdale & Roos and William H. Webster, Attorneys of record for defendant, Robert Hicks, 506 Olive Street, St. Louis 1, Missouri.

Dubail, Judge & Kilker, 317 North 11th Street, St. Louis 1, Missouri, Attorneys of record for defendant, Edwin J. Cunningham.

Lloyd E. Boas, defendant, 901 Washington Avenue, St. Louis 1, Missouri.

Bartlett, Muldoon, Stix and Bartlett and William Stix, 506 Olive Street, St. Louis, Missouri, Attorneys of Record for defendants, George H. Shields III and Jacob Baker.

Robert O. Hetlage, 407 North Eighth Street, St. Louis, Missouri, Attorney of record for defendant, James S. Stubbs.

W. Munro Roberts, Jr., 506 Olive Street, St. Louis 1, Missouri, Attorney of record for defendant, Charles E. Brown.

[fol. 37] Irving Norris, 800 North American Building, Wilmington, Delaware, Attorney of record for plaintiff, Emanuel Josephson.

Biggs, Hensley, Curtis and Biggs and Davis Biggs, 319 North Fourth Street, St. Louis 2, Missouri, Attorney of record for plaintiff, Protective Casualty Insurance Company.

Forrest M. Hemker,
Forrest M. Hemker.

Subscribed and sworn to before me this ..... day of August, 1960.

My commission expires: .....

.....
Notary Public.

Greensfelder, Hemker & Wiese.

In United States District Court for the
Eastern District of Missouri
Eastern Division
Civil Action No. 59 C 162 (3)

Managed Funds, Incorporated, Plaintiff,

vs.

Slayton Associates et al., Defendants.

Notice of Appeal of Jacob Baker and George H. Shields, III, in No. 59 Civil 162 (3)—Filed August 12, 1960

Notice is hereby given that Jacob Baker and George H. Shields, III, defendants in the above-entitled case, hereby

appeal to the United States Court of Appeals for the [fol. 38] Eighth Circuit from the order of the Honorable Randolph H. Weber entered July 1, 1960, denying their motions to dismiss.

Bartlett, Muldoon, Stix & Bartlett, By Daniel Bartlett, Jr., Attorneys for Appellants, Jacob Baker and George H. Shields, III, 506 Olive Street #1211, St. Louis 1, Missouri, Ga 1-2950.

In United States District Court

Relevant Docket Entries in U. S. District Court in No. 59 C 162 (3)

1959

Dec. 3 Motion of George H. Shields, III, appearing specially by his atty. for the purposes of this motion only, to dismiss as to said deft., filed.

Dec. 8 Motion of Jacob Baker (appearing specially and not generally) for leave to dismiss amended complaint, with attached supporting affidavit of movant's attorney, as well as request for time to file memo. in support of motion & for oral argument thereafter, filed.

Dec. 28 Motion of deft. Edwin J. Cunningham to dismiss filed. Oral argument requested. Certificate of service of aforesaid motion filed.

1960

Jan. 8 Motion of defendant Cha es E. Brown to dismiss Cts. I, II, III & IV of plaintiff's amended complaint for lack of jurisdiction over the subject matter, with request for oral argument on said motion, filed.

Jan. 11 Motion of deft. Robert A. Hicks to dismiss filed by leave. Oral argument requested.

[fol. 39]

IN UNITED STATES DISTRICT COURT

RELEVANT DOCKET ENTRIES IN U. S. DISTRICT COURT IN No. 59 C 279 (3)

1960

Jan. 29 Order filed sustaining application of Protective Casualty Ins. Co., a corp., for leave to intervene herein and said corp. is permitted to intervene for the purpose of re-alleging & asserting such relief as sought by the pltff., for joinder of additional parties-defts, but not for the purpose of seeking appointment of a receiver; directing aforesaid intervenor's supplemental complaint heretofore lodged shall continued as lodged, not filed & granting said movant 20 days within which to file a supplemental complaint in accordance with order herein, etc.

Apr. 19 Separate motions (1) of defts W. Munro Roberts, Jr., James J. Mullen, Jr., & J. John Brouk; (2) Jefferson J. Rebstock and (3) Earl R. Rice to dismiss the supplementary complaint of Intervenor, Protective Casualty Ins. Co., and to quash service thereof, and separate supplementary motions of aforesaid defts to dismiss pltff's complaint, together with supporting brief, filed. Certificate as to service filed.

[fol. 40]

IN UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

September Term, 1959

Appeal from the United States District Court
for the Eastern District of Missouri

J. JOHN BROUK, JAMES J. MULLEN, JR., W. MUNRO ROBERTS, JR., JEFFERSON J. REBSTOCK and EARL R. RICE; EDWIN J. CUNNINGHAM; JACOB BAKER and GEORGE H. SHIELDS, III; CHARLES E. BROWN; and ROBERT A. HICKS, Appellants,

No. 166566 vs.

MANAGED FUNDS, INCORPORATED, a Corporation, EMANUEL JOSEPHSON and PROTECTIVE CASUALTY INSURANCE COMPANY.

ORDER GRANTING APPLICATIONS OF J. JOHN BROUK ET AL., FOR LEAVE TO APPEAL—August 5, 1960

The applications of J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock, Earl R. Rice, Edwin J. Cunningham, Jacob Baker, George H. Shields III, Charles E. Brown and Robert A. Hicks, for leave to appeal under 28 U. S. C., § 1292 (b) from an order of the District Court denying the motion of each of them to dismiss the actions of Managed Funds, Incorporated vs. Slayton Associates, Inc.; and Josephson vs. Slayton et al., Nos. 59-C-162 (3) and 59-C-279 (3), in the District Court for the Eastern District of Missouri, on the ground of lack of jurisdiction, having been duly heard and considered—

It Is Hereby Ordered that said applications be and hereby are granted, and the applicants will be allowed to take such an appeal consolidatedly on the question of the correctness of the Court's ruling on the question of juris-

diction as related to the claims asserted against applicants and the denial made of their motions to dismiss on this basis.

August 5, 1960.

[fol. 41]

IN UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 16,566

Appeal from the United States District Court
for the Eastern District of Missouri

J. JOHN BROUK, JAMES J. MULLEN, JR.,
W. MUNRO ROBERTS, JR. et al., Appellants,

—vs.—

MANAGED FUNDS, INCORPORATED, et al., Appellees.

OPINION—January 13, 1961

Before Woodrough, Van Oosterhout, and Matthes, Circuit Judges.

WOODROUGH, *Circuit Judge*:

These appeals are taken from an order of the District Court which denied motions made by appellants to dismiss for lack of jurisdiction of subject matter or person or both in two actions brought against appellants and others by Managed Funds Incorporated and by one Emanuel Josephson. The actions had been consolidated and the order determined that the motions to dismiss the complaints for want of jurisdiction involved a controlling question of law upon which there is a substantial ground for dif-
[fol. 42] ference of opinion and that an immediate appeal from the Court's order may materially advance the ultimate determination of the litigation. Pursuant to application to this Court to appeal under Section 1292(b), 28

U.S.C.A., the appeals were allowed to review the District Court's ruling on the motions to dismiss as related to the claims asserted against these appellants and the denial of appellants' motion to dismiss on jurisdictional grounds.

The plaintiff Managed Funds Incorporated, is a registered open end investment company within the purview of the Investment Company Act of 1940 (54 Stat. Sec. 798-847; 15 U.S.C.A. 80(a) et seq.). Prior to the commencement of the present actions a stop order proceeding was had against it before the Securities and Exchange Commission under Section 8(d) of the Securities Act and a stop order was issued by the Commission upon extensive findings. In re Managed Funds Inc. Par. 76,662, C. C. H. Federal Securities Law Reporter, Current.

The general object and nature of the present consolidated actions is an accounting, injunction and recovery of money damages by Managed Funds for alleged violations of the Investment Company and the Investment Advisers Act of 1940 which are in general the same violations found by the Commission.

The *Josephson* case is a stockholders' derivative action prosecuted for and on behalf of Managed Funds, Inc., but in which Managed Funds, Inc., is named as a defendant. The *Managed Funds* case is a direct action by the corporation itself embracing the same general factual background.

Emanuel Josephson filed the derivative action in the United States District Court, District of Delaware. Man-[fol. 43] aged Funds, Inc., filed its action in the United States District Court, Eastern District of Missouri.

Defendants, Hilton H. Slayton and Hovey E. Slayton, were officers and directors of the fund and owned or controlled defendant, Slayton Associates, Inc., the Funds' Investment Adviser and defendants, Slayton and Company, Inc. and Mutual Fund Distributors, Inc. which were engaged in the selling of Funds' shares. Defendant, Model, Roland & Stone, is a stock brokerage partnership composed of the individual defendants indicated. These appellants and defendants, Boas, Cunningham, Hicks, Jester, Shields and Stubbs are former members of the Board of Directors of Managed Funds, Inc.

The Josephson complaint rests jurisdiction on the claimed violation of the Investment Company and Adviser's Act of 1940, and rules of the Securities and Exchange Commission promulgated thereunder. Managed Funds' Amended Complaint rests jurisdiction on alleged violations of the Investment Company Act of 1940 and rules of the Securities and Exchange Commission promulgated pursuant to it.

Appellant, Jefferson J. Rebstock, and appellant, Earl R. Rice, are citizens and residents of the State of Louisiana. They appeared specially and by motions sought dismissal of the four counts of Funds' amended complaint for lack of jurisdiction of both subject matter and person. Appellants, W. Munro Roberts, Jr., J. John Brouk and James J. Mullen, Jr., are citizens and residents of the State of Missouri. They moved to dismiss for lack of jurisdiction of subject matter. Like motions were filed respecting the Josephson complaint and the adoption thereof by Protective Casualty Insurance Company. Similar motions were filed by all appellants on this appeal.

[fol. 44] These appellants and some other directors are denominated by Fund in the Amended Complaint as "outside directors", that is directors alleged to have had actual or constructive knowledge of the alleged wrongful acts of the Slaytons individually and the Slayton Companies and broker defendants.

The facts pleaded in Count I of Funds' Amended Complaint are substantially as follows:

That the plaintiff, Managed Funds, Incorporated, is a registered open end investment company under the Investment Company Act selling its shares to the general public through underwriters, distributors, dealers and salesmen. That Fund entered into a contract with Slayton Associates, Inc., whereby it became "Funds' Investment Adviser" for agreed compensation of ½ of 1% of the asset value of Funds' asset portfolio, consisting of shares of common stock of various companies. That in December of 1953, Slayton Associates, Inc. employed defendant, Jaquith, as investment counselor and manager of Funds' securities portfolio and delegated its duties as investment adviser to defendant, Jaquith; that Slayton Associates, Inc., agreed to pay Jaquith, $50,000.00 a year for five

years beginning in December of 1953, and a minimum of $35,000.00 a year for the next succeeding five years, which payments were to be applied against brokerage commissions Jaquith or his designees would receive respecting Funds' brokerage business channeled to Jaquith; that Jaquith channeled Funds' business to the stock brokerage partnership of Model, Roland & Stone, defendant herein, of which Jaquith was a member, whereby such partnership received brokerage commissions of over $1,500,000.00; that Jaquith and Model, Roland and Stone paid $50,000.00 a year to defendants Smith and Stubbs, for which no ser- [fol. 45] vices were performed, it being averred that Stubbs is a former business associate of the Slaytons and an employee and representative of Model, Roland and Stone, a former director of the Fund; that defendant, Smith, is also an employee and representative of defendant, Model, Roland and Stone, and a brother-in-law of defendant, Hovey E. Slayton.

That Funds' announced policy in offering its shares as contained in reports and prospectuses filed with the Securities and Exchange Commission was to provide for capital growth and reasonable income consistent therewith by realized profits on the sale of portfolio securities and dividends; and to make quarterly distributions to its shareholder; that after the arrangement with Jaquith, it is averred this policy was not followed, and distribution to shareholders were made of a predetermined income to meet which it was required that capital gains be realized, thereby permitting defendants, Slayton and Company, Incorporated, and Mutual Fund Distributors, Incorporated to make greater commissions and profits from the sale of Funds' shares. This policy, it is averred, resulted in mismanagement, loss and damage to Funds' investment portfolio by increased brokerage commissions for purchase and sale of portfolio securities and greater payments to Jaquith by Slayton Associates, Inc.; that Fund was caused to place its brokerage business for the sale of portfolio securities with brokers who also sold Funds' shares, and with brokers who rendered services to Slayton Associates, Inc., and to Slayton and Company, Inc., and Mutual Fund Distributors, Inc. seller and distributor of Funds' shares

to satisfy obligations of companies for services rendered to them.

By paragraph 21 of Count I of the Funds' amended petition, it is averred that:

> [fol. 46] "The defendants committed, or with actual or constructive knowledge, as herein above set forth, aided, abetted, acquiesced in or condoned, directly or indirectly, violations of the Investment Company Act of 1940."

by (a) operating the fund in the interest of directors, etc., rather than Funds' security holders, [15 U.S.C.A. 80a-1 (b)2] caused Fund to publish and circulate documents containing untrue statements or omitting material facts, [15 U.S.C.A. 80a-33]; (c) caused Fund to deviate from a fundamental investment policy, [15 U.S.C.A. 80a-13] and (d) that defendants, Model, Roland and Stone and Jaquith, acted as investment advisers without a written contract approved by the outstanding voting securities of Fund. [15 U.S.C.A. 80a-15(a)]

Count II of Funds' Amended Complaint avers that the Court has jurisdiction of Count II because it is based on the same acts alleged in Count I of which the Court has jurisdiction under the Investment Company Act. And it is averred that Fund may be liable to purchasers of its shares by reason of the defendants having caused Fund to file false registration statement required by the Securities Act of 1933; that the Securities and Exchange Commission issued a stop order and that Funds' name and good will were damaged, and that Fund expended money for counsel fees and other expenses in connection with the Securities and Exchange proceedings.

Count III bases jurisdiction on the same grounds as Count II and avers that Slaytons individually occupied a fiduciary relationship with Fund as Funds' President and Vice-President; that Model, Roland and Stone and Jaquith acted as investment advisers and therefore occupied a fiduciary relationship; that each of the other defendants had actual knowledge of the fiduciary relationship of the [fol. 47] Slaytons to the Fund, and constructive knowledge of the fiduciary relationship of Model, Roland and Stone

and Jaquith to the Fund; that the Slaytons and Model, Roland and Stone breached their fiduciary duties, committed waste and mismanaged Fund, and all except for the "outside directors" profited thereby; that all defendants, including the "outside directors" by reason of actual knowledge or constructive knowledge of the fiduciary relationships of the Slaytons and Model, Roland and Stone to Fund are liable for their acts.

Count IV adopts the allegations of Count I except paragraphs 20, 21 and 22 and paragraphs 3 through 6 of Count III, and avers a conspiracy between all defendants, except the "outside directors" who, it is averred, had actual or constructive knowledge and failed to do anything to prevent the actions of the other defendants, and are therefore liable to Fund.

Prayer of each of the Counts is for money damages, and for an accounting for profits as to all defendants.

The Josephson complaint recites the same basic facts as Count I of Funds' Amended Complaint and the same violations by Fund, and avers that "the wrongful acts herein described have been and continue to be committed by the defendants against Managed Funds in breach of legal and fiduciary obligations that are inherent by reason of the relationship of the parties". Josephson prays for an injunction in addition to an accounting and damages.

The District Court of Delaware transferred the *Josepson* case to the United States District Court, Eastern District of Missouri and the cases were consolidated.

Pursuant to an order entered by the District Court, the Protective Casualty Insurance Company, a corporation, [fol. 48] was allowed to intervene as a party plaintiff in the *Josephson* case. The Protective Casualty Insurance Company, as an intervening party, adopted the complaint of Emanuel Josephson as its complaint.

On July 1, 1960, the District Court, by its order, denied each and all of the appellants motions to dismiss for lack of jurisdiction of subject matter and or person.

The points presented by appellants for reversal of the order are: 1. That the Investment Company Act of 1940 does not expressly or by implication create any statutory duty or liability respecting directors of an investment

company, the violation of which gives rise to a cause of action by such investment company against these directors which is within the jurisdiction of the District Court of the United States. 2. Mere violations of the federal statute does not as a matter of general law create a case of which Federal Courts have jurisdiction and the theory of federal jurisdiction by implication has been rejected in security cases where corporations have sought to hold directors for claimed statutory violations and mismanagement or breach of duty. 3. The legislative history of the Investment Company Act of 1940 discloses a complete lack of congressional intent to create a body of federal law respecting liability of directors of investment companies.

In support of the first point appellants recall that the Federal Courts are not courts of general jurisdiction but are courts of special or limited jurisdiction in that they have no jurisdiction except that conferred by the Constitution and laws of the United States, 54 Am. Jur. United States Courts Sec. 10, p. 671 and that;

> "A suit to enforce a right which takes its origin in the laws of the United States is not necessarily, or for that reason alone, one arising under those laws, for a [fol. 49] suit does not 'arise' unless it really and substantially involves a dispute or controversy respecting the validity, construction or effect of such a law, upon the determination of which the result depends." *Gully* v. *First National Bank*, 299 U.S. 109, 114.

Appellants point out that neither complaint here involved attempts to base jurisdiction on any federal statute other than the Investment Company Act and the Investment Adviser's Act of 1940 and that the claim of jurisdiction to be sustained must fall within the category of a right created by the act of Congress whereby jurisdiction is conferred upon the Federal Courts without regard either to diversity of citizenship of the parties or the amount in controversy.

The Investment Company Act of 1940, 15 U.S.C.A. 80a-1-52, and the Investment Advisers Act of 1940, 15 U.S.C.A. 80b-1-21, are the fifth in a series of six Congressional enactments relating to securities. The Securities Act of 1933,

15 U.S.C.A. 77a-77aa, the Securities Exchange Act of 1934, 15 U.S.C.A. 78a-jj, the Public Utility Holding Company Act of 1935, 15 U.S.C.A. 79a-z and the Trust Indenture Act of 1939, 15 U.S.C.A. 77aaa-77bbb each contain express provisions for private civil actions. See, 77k, 77l, 78i(e), 78r, 79p, and 77www. Directors may be sued under 77k. Under 78p(b) insiders profits may be recovered by an "issuer", or if it refuses to sue, through a security holder of an issuer in its name. There are provisions for limitations, joint liability and rights of contribution, 77m, 77k(l), 78aa and 77k. By contrast neither the Investment Company Act nor the Investment Advisers Act of 1940 contain any such provisions. The Investment Company and Advisers Acts neither make any definition of the duties of directors nor provide anywhere that a registered investment company may sue its directors.

[fol. 50] Respecting jurisdiction of the District Courts, the Investment Company Act provides:

"Sec. 80a-43. Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter and sections 72 (a) and 107 (f) of Title 11, or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and sections 72 (a) and 107 (f) of Title 11 or the rules, regulations, or orders, thereunder. Any criminal proceeding may be brought in the district wherein any Act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 80a-33 of this title, or upon a failure to file a report or other document required to be filed under this subchapter and sections 72 (a) and 107 (f) of Title 11, may be brought in this district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created

by, or to enjoin any violation of, this subchapter and section 72 (a) and 107 (f) of Title 11 or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in section 225 and 347 of Title 28 and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding un- [fol. 51] der this subchapter and section 72 (a) and 107 (f) of Title 11 brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title I, Sec. 44, 54 Stat. 844."

The Advisers Act provides:

"Sec. 80b-14. Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceedings may be brought in the district wherein any suit or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business, or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review

as provided in section 225 and 347 of Title 28, and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title II, Sec. 214, 54 Stat. 856."

The jurisdiction section of the 1933 Act, 15 U.S.C.A. 77v, the Public Utility Holding Company Act, 15 U.S.C.A. 79y, and the Trust Indenture Act, 15 U.S.C.A. 77vvv, are substantially the same as 80a-43. The Exchange Act pro- [fol. 52] vides that the United States Courts have "exclusive jurisdiction" to enforce liabilities or duties created by that Act. 15 U.S.C.A. 78aa.

The express wording of the Investment Company Act above is that criminal jurisdiction for violations is exclusively in the District Courts of the United States and civil jurisdiction is concurrently in State Courts and Federal Courts "of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter * * * ". The Advisers Act confers jurisdiction of violations and suits to enjoin violations, and says nothing about duties or liabilities of directors.

The absence of specific language creating civil liability respecting private actions narrows the jurisdictional question presented by this appeal to whether or not directors' liability to registered investment companies which they serve has been created by implication.

Under some of the federal legislation relating to security transactions federal jurisdiction of private actions has been upheld by implying a right of action respecting contracts declared void by the statute and by implying a right of action for damages in tort for violation of the federal statute.

Appellants recognize that the doctrine is well supported that a cause of action within the federal jurisdiction exists by implication in the security field in suits brought by purchasers of securities against sellers or by sellers

against purchasers on account of violations more particularly under the 1933 and 1934 Acts. The record of the development of the doctrine is shown in the Annotation to [fol. 53] *Fratt* v. *Robinson*, 203 F.2d 627, (1953) in 37 A.L.R. 2d 649 and it appears that the jurisdiction has been implied first under the general provisions of the Exchange Act, the Holding Company Act and the Investment Company and Investment Advisers Act to the effect that contracts in violation of the Acts or rules thereunder are void. The applicable Investment Company Act provision is as follows:

"Section 80a-46. Validity of contracts.

(a) Any condition, stipulation or provision binding any person to waive compliance with any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or with any rule, regulation, or order thereunder shall be void.

(b) Every contract made in violation of any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or of any rule, regulation, or order thereunder, and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, regulation, or order. Aug. 22, 1940, c. 686, Title 11, Sec. 47, 54 Stat. 845."

The second basis of liability, is "the common law tort doctrine of private action based on violation of a statute". [fol. 54] It is the position of appellants that the void con-

tract theory of liability and the theory of tort liability based on violation of a federal statute has been rejected by the courts in situations where director liability to their corporation has been involved. Further, that the legislative history of the Acts here involved shows a complete absence of any legislative intent to create such private actions against directors by investment companies cognizable in the Federal Courts.

The appellants refer to the case of *Kardon* v. *National Gypsum Co., et al.* (D.C.E.D. Pa., 1946), 69 F.Supp. 512, as the root case containing judicial pronouncement of the two theories on which federal jurisdiction has been implied.

This was a fraud case under the Exchange Act of 1934 to recover damages against the National Gypsum Company and others for inducing plaintiffs to sell their stock in two corporations for less than true value. The court was ruling on motions of defendant to dismiss for lack of jurisdiction of person and failure to state a claim. By Rule X-10B-5 implementing 78j, the Security Exchange Commission made it unlawful for any person to employ deceptive devices in the purchase or sale of securities. The Court stated the question was whether the conduct complained of gave rise to a liability or involved a breach of duty created by the 1934 Act and then held:

> "It is not, and cannot be, questioned that the complaint sets forth conduct on the part of the Slavins directly in violation of the provisions of Sec. 10 (b) of the Act and of Rule X-10B-5 which implements it. It is also true that there is no provision in Sec. 10 or elsewhere expressly allowing civil suits by persons injured as a result of violation of Sec. 10 or of the [fol. 55] Rule. However, 'the violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if; (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is intended to protect. * * * '. Restatement, Torts, Vol. 2, Sec. 286. This rule is more than merely a canon of statutory

> interpretation. The disregard of the command of a statute is a wrongful act and a tort."

The court also predicated liability on the void contract-theory saying:

> "Apart from Sec. 10 (b), I think that the action can also be grounded upon Sec. 29 (b) of the Act which provides that contracts in violation of any provision of the Act shall be void. Here, unlike the point just discussed, the question is purely one of statutory construction. It seems to me that a statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it. The statute would be of little value unless a party to the contract could apply to the Courts to relieve himself of obligations under it or to escape its consequences. Beyond this, however, as pointed out by Judge Coxe in *Geismar* v. *Bond & Goodwin, Inc.*, D.C., 40 F.Supp. 876, 878, the 1938 amendment which deals in part with actions 'maintained in reliance upon this subsection' clearly contemplates that Congress meant the original statute to be interpreted as providing for civil suits under it. And, as he further pointed out, such suits would include not only actions for rescission but also for money damages."

It is significant that in speaking of the void contract theory the court says a *party* may be relieved of contract obligations induced by violations and appellants insist that the Security Act provisions voiding contracts in violation [fol. 56] of the Acts can apply, only where plaintiff and defendant in an action for relief under the Acts are in privity of contract or perhaps where plaintiff can work out a third party beneficiary relationship. None of appellants here are parties to the advisory contract between Associates and Fund or the contract between Associates Jaquith and Model, Roland and Stone. They say they can not be brought within the doctrine of *Kardon* v. *National Gypsum Co. et al.*, supra. Furthermore, that the defendants in the action were the ones charged with violating the Acts was conceded in

Kardon, whereas appellants contend the complaints here charged no statutory duties or liabilities respecting directors which these directors have violated.

2.

Under their second point appellants contend that the courts have rejected implication of federal jurisdiction in director liability cases. They cite *Howard* v. *Furst* (2d Cir. 1956), 238 F.2d 790, aff'd, S.D.N.Y. 140 F.Supp. 507. That was a derivative suit on behalf of Circle Wire & Cable Corporation against officers and directors of Circle who held over 60% of Circle's shares. There was no diversity. Federal jurisdiction was asserted under the Exchange Act of 1934, Section 78aa. The complaint alleged that Circle had an agreement to sell and a Cerro de Pasco Corporation an agreement to buy Circle's property and business for over twenty million dollars; that the individual defendants to advance their own private interest negotiated the sale for less than the value of the assets of Circle; that the sale would constitute a waste of Circle's assets; that the directors by virtue of their position and as controlling stockholders of Circle abused their fiduciary obligations. That a proxy statement of Circle's share-[fol. 57] holders meeting to vote upon the sale was false and misleading, in that it understated the cost and value of Circle's inventory and its earnings and failed to disclose the private interests of the officers and directors of Circle. Section 78n (a) made it unlawful to solicit proxies by use of the mails in contravention of rules of the S.E.C. and by Rule X-14A-9 the S.E.C. had proscribed false or misleading material in proxy statements. The prayer for relief was to declare the proxies void; to enjoin certain individual defendants from voting, to declare the sale contract void, and to rescind it and restore the status quo and alternatively, if this be impossible, that Circle recover damages from Cerro and the individual defendants directors of Circle. In summing up the complaint the Court said; "In other words, appellant asserted a claim for an injunction against the sale, which, now that the sale has gone through, has become a claim for rescission or for

the damages suffered by Circle, not by appellant". The Court sustained the action of the District Court, S.D.N.Y. 140 F.Supp. 507, dismissing the complaint for lack of jurisdiction of the subject matter, Circuit Judges Hand, Medina, and Hincks sitting. The Court said:

> "As the case is said to be one 'arising under' the laws of the United States, our first inquiry is addressed to appellant's contention that the statutory provisions above quoted create or give rise to a substantive civil right on behalf of Circle, which may be enforced in a derivative action by an individual stockholder. We reject this contention as unsound. We find nothing in the language of Section 14 (a) or in the legislative history of the Securities Exchange Act of 1934 to warrant an inference that it was the intention of the Congress to create any rights whatever in a corporation whose stockholders may be solicited by proxy statements prepared in contravention of the statutory mandate."

[fol. 58] The Court pointed out that where the 1934 Act created a corporate action for insider profits this was done by an express provision 15 U.S.C.A., Sec. 78p (b). Applying the federal right test of the *Gully* case, supra, the Court said:

> "Applying this test it is clear to us that every essential element of appellant's case depends upon the common law and the statutes of the state of New York. If the individual defendants who controlled 60.68% of Circle's outstanding stock, in violation of their fiduciary duties as directors and officers of Circle, brought about a sale of Circle's assets for a grossly inadequate sum, all in furtherance of their personal and private interests, the case would be ripe for judgment for rescission of the sale or for damages, wholly irrespective of whether some or all of the individual defendants had participated in the formulation and sending out of a false or misleading proxy statement. The allegations with reference to the proxy statement constitute a mere

excrescence or superfluity tacked onto what are otherwise sufficient allegations of a claim for relief under New York law."

Appellants also cite *Downing* v. *Howard*, 162 F.2d 654 (3rd Cir. 1947), aff'd, 68 F.Supp. 6 (D.D.C. 1947). The nature of the action is described by the Court as follows:

> "Plaintiff is the owner of shares of United Corporation (of Delaware), hereafter called United. He brought this action in the United States District Court for the District of Delaware on behalf of himself, other shareholders of United, and the Corporation against individuals or, in some instances, their personal representatives, who had been directors of United and certain other persons alleged by plaintiff to have conspired with the directors to the detriment of the Corporation. Most of the individual defendants are neither residents of Delaware nor engaged in business there. Plaintiff, [fol. 59] however, says that he is properly in the federal court under Sec. 25 of the Public Utility Holding Company Act of 1935. He concedes that unless he has stated a cause of action 'created' by that statute his action in the District Court of Delaware will not lie."

By the third count it was claimed the directors failed to file with the SEC a plan of reorganization. The Court held:

> "The fatal obstacle to the plaintiff's complaint on this score is that the legislation does not require the company to furnish a plan. A cause of action can hardly be based upon disobedience of the statute when the statute does not require the act, the non doing of which is complained of by the plaintiff. Plaintiff's complaint, therefore, as to this cause of action stops at this point so far as it is predicated upon liability under the federal statute."

By the first count it was alleged the directors failed to register United and that while United was unregistered it

held securities which depreciated $87,000,000.00. The Court held there was no duty on a registered company to sell its securities, hence failure to register had no legal connection with the loss. Count two, also based on failure to register averred that an option exercised by directors which turned out to be a bad guess would not have happened if United was registered. The Court said:

> "Plaintiff's theory is that if United had refrained from voting and exchanging as required by Sec. 4 (a) (6), 4 (a) (3), and 4 (a) (4) of the Act, there would have been no loss since the consolidated preferred has maintained its market value and all accumulated dividends have been paid . . . Plaintiff does not allege, and we do not know, what would have happened with regard to this exchange of shares had United been registered and all the facts which a registration re- [fol. 60] quires had been brought out. Even if the plaintiff had alleged that the exchange would never have taken place if United had been registered the complaint would still stop short of being legally sufficient unless it stated facts showing that the loss suffered happened in a way the statute was enacted to prevent. This he failed to do. We do not think, therefore, that what plaintiff complains of was occasioned either by owning or exchanging unless, as discussed above, the statute violator is to be held to complete insurer's liability."

District Judge Leahy in dismissing the *Downing* case below summarized his views as follows:

> "Clearly, then, the suit at bar is not a 'suit in equity • • • brought to enforce any liability or duty created' by the Act. Absent other jurisdictional elements, a minority stockholder may not resort to the federal courts on simple allegations that directors and officers, with other coconspirators, have violated federal statutes—such as anti-trust laws and the Interstate Commerce Act, 49 U.S.C.A. Sec. 1 et seq.—in addition to committing breaches of fiduciary duty." 68 F.Supp. at 10.

Birnbaum v. *Newport Steel Corporation*, 193 F.2d 461, (2d Cir., 1951) is also cited. There the Second Circuit had before it a suit brought on behalf of the Newport Steel Company by shareholders alleging jurisdiction under the Securities Exchange Act of 1934, 15 U.S.C.A. 78aa. Violation of fiduciary obligations by directors was pleaded in selling their stock in Newport and making fraudulent reports to Newport's stockholders. It was claimed S.E.C. Rule X-10B-5 was violated. The Court held that the claimed violations had no relation to breach of fiduciary duties by corporate insiders which resulted in fraud upon stockholders who were neither buyers nor sellers (the protected class under the 1933 and 1934 Acts).

[fol. 61] The Court rejected plaintiff's contention that the rule supplemented the common law liability of those who abuse the trust of their corporate positions and created a federal case and said:

> "But the appellants argue that such an interpretation of the Rule is too narrow to carry out the broad purpose of the Act to protect investors 'from exploitation by corporate insiders'. * * * We do not doubt that Congress was at least partially motivated by such a purpose in enacting the Securities Exchange Act of 1934, 15 U.S.C.A. Sec. 78a et seq. However, the precise question here is whether Section 10(b) of the Act and the Commission's Rule X-10B-5 were the means chosen to further that end, and we are of the opinion that the legislative 'history' and 'purpose' quoted by appellants are not persuasive that they were. When Congress intended to protect the stockholders of a corporation against a breach of fiduciary duty by corporate insiders, it left no doubt as to its meaning.[1]

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[1] We observe that when Congress intended to create a federal case of director liability it made its meaning clear. The National Banking Act provides that directors of a National Bank who knowingly permit any of the officers, agents or servants of the association to violate any provisions of the Act, every director who participated in or assented to the same is to be held liable in his personal and individual capacity for all damages which the association, its shareholder or any other person shall have sustained in consequence of such violation 12 U.S.C.A. Section 93.

Thus Section 16 (b) of the Act of 1934, 15 U.S.C.A. Sec. 78p (b) a right of action against corporate insiders using their position to profit in the sale or exchange of corporate securities. The absence of a similar provision in Section 10 (b) strengthens the conclusion that that section was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10B-5 extended protection only to the defrauded purchaser or seller. Since the complaint failed to allege that any of the plaintiffs fell within either class, the judgment of the district court was correct and is accordingly affirmed."

[fol. 62] The appellants then cite non-security cases illustrating lack of federal jurisdiction when none is legislatively conferred as follows:

Meyer et al. v. *Kansas City Southern Railway Company* (2 Cir. 1936), 84 F.2d 411, stockholders derivative action for conspiracy against railroads and directors alleged violation of antitrust laws;

Jacobson v. *New York, N. H. & H. R. Co.* (1 Cir. 1953), 206 F.2d 153, violation of Safety Appliance Acts;

Consolidated Freightways v. *United Truck Lines* (9 Cir. 1954), 216 F.2d 543, violation of Motor Carrier Act;

Miller v. *Long* (4 Cir. 1945), 152 F.2d 196, violation of National Housing Act;

Republic Pictures Corp. v. *Security First National Bank* (9 Cir. 1952), 197 F.2d 767, case involving mortgage on a copyright;

State Automobile Ins. Ass'n v. *Parry* (8 Cir. 1941), 123 F.2d 243;

Note: 14 A.L.R. 2d 992—What actions arise under the laws and treaties of the United States so as to vest jurisdiction of Federal Courts.

3.

As to the lack of congressional intent to create a body of federal law respecting liability of directors of invest-

ment companies. Such review as we have been able to make of the legislative history has afforded little assistance either in justifying or refuting the implication of a private right of suit such as claimed here. Senate and House Committees reports are devoid of clear reference to civil liability except with respect to provisions expressly imposing it. We are cited to the analysis of the Investment Company Act of 1940 in 50 Yale L. J. 441, 446, that "the original draft of [fol. 63] the section" (now 15 U.S.C.A. 80a-9) "which required all investment company officers and directors to register as individuals with the S.E.C. and become subject to such disqualification as that body should propose drew a storm of protest from the industry." As passed, the director registration requirement was deleted. The original bill had further provided that if any person registered under the Act was guilty of gross misconduct or gross abuse of trust he would be guilty of a crime. This provision was omitted from the Act. The note in the journal continued by saying, that: "It was suggested during the hearings on the original bill that this whole problem" (managerial responsibility) "could be solved most expeditiously by declaring investment company managements to be trustees in fact with trustee obligations to their stockholders." This proposal, however, which would have involved drastic managerial responsibility, was rejected except to the extent that "gross abuse of trust" was made a ground for restraining the guilty party from further connection with the industry. The "gross abuse" section referred to is 15 U. S. C. A. 80a-35 and the Securities and Exchange Commission is the one there authorized to bring the action.

Congress did refrain from including in the Acts any control or regulation or expansion of the common law duties of directors of investment companies and the failure to provide any private civil remedies or for joint and several liability or contribution or statutes of limitation such as are found in the 1933 and 1934 Acts indicates that the omission was deliberate. At common law directors are liable to exercise due care and to render them liable by implication on account of violations of the Acts by others would be a drastic innovation.

[fol. 64] Senator Lodge of Massachusetts stated in the Senate on June 21, 1940, in urging the passage of the present Act:

> "It so happens that the investment trust business is one which very largely had its origin in Boston and I happen to know a great many people connected with this industry. • • •
>
> This bill, as the Senator from New York has said, was agreed upon after very painstaking and careful study, in which really almost a miracle occurred, in that all the various elements in the industry were able to get together and organize themselves, and present a common basis for studying the question, and as the result of that effort an agreement which is embodied in this bill was reached between those engaged in the industry and the members of the S.E.C. I submit that that is a very unusual and very beneficial occurrence—."

It seems improbable that there would have been such unanimity for the passage of the Act if it had been thought to impose any such per se liability on directors as is claimed by plaintiffs here. The failure to provide for any private civil remedies or for joint and several liability of directors and persons who commit or contribute to violations or for statutes of limitations or for conditions is persuasive that the omission was deliberate. Certainly, the Courts will imply a liability only to implement a manifest legislative intent. The enactments as they stand do not justify implications that jurisdiction was intended to be conferred.

The appellees in support of the jurisdiction and the ruling appealed from contend that the facts alleged in the complaints state a claim upon which the Investment Company Act of 1940 provides a remedy to Managed Funds and against appellants in the Federal District Court. They [fol. 65] have cited and relied on the following provisions of the Act and texts and decisions:

Alfred Inv. Trust et al. v. *Securities and Exchange Commission*, 151 F.2d 254 (1st Cir., 1945)

Alleghany Corporation v. *Breswick & Co.*, 353 U.S. 151 (1957)
Baird v. *Franklin*, 141 F.2d 238 (2d Cir., 1944)
Bell v. *Hood*, 327 U.S. 678 (1945)
Birnbaum v. *Newport Steel*, 193 F.2d 461 (2d Cir., 1951)
Brandt v. *Renfield*, 278 F.2d 904 (8th Cir., 1960)
Breswick & Co. v. *United States*, 134 F.Supp. 133 (S.D.N.Y., 1955), 138 F.Supp. 123 (1956)
Breswick & Co. v. *Briggs*, 135 F.Supp. 397 (1955)
Cogan v. *Johnson*, 162 F.Supp. 907 (S.D.N.Y., 1958)
Collings v. *Busch Manufacturing Co.*, 19 F.R.D. 297, (S.D.N.Y., 1956)
Downing v. *Howard*, 68 F.Supp. 6 (D. Del. 1946) 162 F.2d 654 (3d Cir., 1947)
Errion v. *Connell*, 236 F.2d 447 (9th Cir., 1956)
Fielding v. *Allen*, 181 F.2d 163 (2d Cir., 1950)
Fischman v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951)
Fratt v. *Robinson*, 203 F.2d 627 (9th Cir., 1953)
Goldstein v. *Groesbeck*, 142 F.2d 422 (2d Cir., 1944)
Gully v. *First National Bank in Meredian*, 299 U.S. 109 (1936)
Hawkins v. *Merrill Lynch, Pierce, Fenner & Beane*, 185 F.Supp. 104 (W.D.Ark., 1949)
Hooper v. *Mountain States Securities Corporation*, Par. 90,972, C.C.H. Federal Securities Law Reporter.
Howard v. *Furst*, 238 F.2d 790 (2d Cir., 1956)
Hurn v. *Oursler*, 289 U.S. 238 (1933)
R. H. Johnson & Co. v. *S.E.C.*, 198 F.2d 690 (2d Cir., 1952)
Jung v. *K & D Mining Co.*, 260 F.2d 607 (7th Cir., 1958)
Kardon v. *National Gypsum Co.*, 69 F.Supp. 512 (E.D.Pa. 1946), 73 F.Supp. 798 (1947)
[fol. 66] *In re Managed Funds, Incorporated*, Par. 76,662, C.C.H. Federal Securities Law Reporter, Current.
Schwartz v. *Bowman*, 156 F.Supp. 361 (S.D.N.Y. 1957)
Schwartz v. *Eaton*, 264 F.2d 195 (2d Cir., 1959)

Slavin v. *Germantown Fire Ins. Co.*, 174 F.2d 799 (3rd Cir., 1949)
Sparks v. *England*, 113 F.2d 579 (8th Cir., 1940)
Stadia Oil & Uranium Co. v. *Wheelis*, 251 F.2d 269 (10th Cir., 1957)
Stella v. *Kaiser*, 82 F.Supp. 301 (S.D.N.Y., 1948)
Taussig v. *Wellington Fund, Inc.*, Par. 90,979, C.C.H. Federal Securities Law Reporter, Current 187 F.Supp. 179, (D. Del., 1960)

Statutes Cited:

79j (Rule X-10B-5), 78aa, 78p of Title 15, U.S.C.A., 79y, 79z of Title 15, U.S.C.A.
80a-1 (b) of Title 15, U.S.C.A.
80a-2 (a) (19) of Title 15, U.S.C.A.
80a-8 (b) of Title 15, U.S.C.A.
80a-10 of Title 15, U.S.C.A.
80a-13 (a) (3) of Title 15, U.S.C.A.
80a-15 of Title 15, U.S.C.A.
80a-16 of Title 15, U.S.C.A.
80a-33 of Title 15, U.S.C.A.
80a-43 of Title 15, U.S.C.A.
80a-46 (b) of Title 15, U.S.C.A.
80a-47 of Title 15, U.S.C.A.

Rules Cited:

Rule 8a Federal Rules of Civil Procedure.

Texts Cited:

Congressional Record, 1940, P. 10074
Green, George Washington Law Review, Vol. 28
Jaretski, 26 W.U.L.Q. 303
61 Harvard Law Review 858
Report of Hearing of H.B. 100065, Subcommittee of Committee of Interstate and Foreign Commerce (76th Congress, 3rd Session)
[fol. 67] Restatement of the Law of Torts, Section 286
Senate Report No. 1775, 76th Congress, 3rd Session June 6, 1940.

In the first place, the appellees stress the decision in the *Kardon* case, supra, and the fact that the Court there found federal jurisdiction by implication both because the defendant had violated a legislative enactment causing damage to plaintiff and because the statute declared that the contract so obtained in violation "shall be void". We do not express disagreement in any respect with the *Kardon* decision and others in accord with it. In *Kardon* the party damaged by a contract obtained in violation of a federal law, which contract the law made void, was allowed to sue in federal court the party who offended and profited. But we do not hold the situation here to be analogous.

Goldstein v. *Groesbeck*, 142 F.2d 422, (2d Cir., 1944) involved a void contract under the Holding Company Act. Defendant, Electric Bond & Share, was the top holding company and through American Power & Light it controlled four power companies. It had construction contracts with the power companies and caused the contracts to be taken over by corporations organized by it. By the Act it was unlawful for an unregistered holding company to enter into construction or service contracts with public utilities. Goldstein brought the action as a shareholder of American derivatively for American and the controlled power companies to compel an accounting for profits gained by the construction and service corporations and certain of their officers and directors. The court decided that but for the Act the payment under the contracts would have been lawful, therefore, "the words 'any liability or duty' are clearly broad enough to include any [fol. 68] breaches of duty causing injury or loss to private persons." The void contract theory is enunciated as follows:

> "As we have seen, the Act makes it unlawful for unregistered holding companies to enter 'directly or indirectly' into service or construction contracts . . .
>
> Violation being thus established, Sec. 26 (b), 15 U.S.C.A. Sec. 79z (b), in express terms declared the contracts void. It should follow that the operating companies are entitled to a refund, for no other result can fulfill the expressed purpose of the Act

of protecting subsidiaries from the overreachings of holding companies. Thus, the statutory declaration of the necessity for control of holding companies in Sec. 1 (b) (2), 15 U.S.C.A. Sec. 79a (b) (2), states, inter alia, that the national public interest is adversely affected 'when subsidiary public utility companies are subjected to excessive charges for services'. The three specific sanctions stated in the Act—injunction, Sec. 18 (f), 15 U.S.C.A. Sec. 79r (f); criminal punishment, Sec. 29, 15 U.S.C.A. Sec. 79z-3; and the negative relief of Sec. 26 (b), declaring the contracts void- do not in terms place the defrauded operating company in status quo; and Sec. 26 is incomplete, if not ineffective, unless it is considered to authorize recovery by the operating companies . . .

. . . Furthermore, the analogy of the Securities Exchange Act is again useful. Private enforcement of Sec. 29 (b) of that statute has been permitted, *Geismar* v. *Bond & Goodwin, Inc.*, supra, while we have recently upheld broadly the private rights of action impliedly granted by the Securities Exchange Act, *Baird* v. *Franklin*, 2 Cir., 141 F.2d 238; and cf. *Charles Hughes & Co.* v. *S. E. C.*, 2 Cir., 139 F.2d 434, certiorari denied 64 S.Ct. 781. As we have pointed out in those cases, we think a denial of a private right of action to those for whose ultimate protection the legislation is intended leaves legislation highly publicized as in the public interest in fact sadly wanting, and even delusive, to that end."

[fol. 69] The case did not involve asserted liability of the directors of Electric Bond & Share to it for causing it, through its controlled construction and service corporation, to enter into the void contracts with the power companies. Goldstein sought an accounting for "profits" made by the directors and the construction and service companies illegally contracting with the operating companies. Electric Bond & Share was a party because it acted through its controlled construction and service corporation. In other words, this was a suit for recovery of the consideration paid by the operating companies under the void contract.

The Court carefully reserves the question of whether the recovery would be for the entire consideration or the excess thereof over the reasonable value of the services rendered. The case illustrates that jurisdiction implied under the void contract theory requires privity and does not hold that directors may be held liable to account to the corporation for return of a consideration which they did not receive.

Referring to *Geismar* v. *Bond & Goodwin, Inc.*, supra, the Court there said:

> "A useful analogy in favor of this interpretation of implied liability can be found in Sec. 29 of the Securities Exchange Act which is virtually identical with Sec. 26 of the Utility Act for it is now clear from the 1938 amendment to Sec. 29, 52 Stat. 1076 that Congress intended a right of recovery thereunder."

The section referred to is 15 U.S.C.A. 78cc (b) and the 1938 amendment is a provision added to the void contract section of the Exchange Act of 1934 reading:

> "Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to para- [fol. 70] graph (2) or (3) of subsection (c) of Section 78o of this title, and (b) that no contract, shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection by any person to or for whom any broker or dealer sells, or buying from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 78o of this title, unless such violation is brought within the year after discovery and within three years after such violation."

Appellees argue that as the corporation acts through its officers and directors such parties in control must be held liable because if the company violates the acts they directly or indirectly cause the violation. They contend

that the directors should be held liable under Section 80a-47 which provides:

"(a) It shall be unlawful for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do under the provisions of this subchapter and section 72 (a) and 107 (f) of Title 11 or any rule, regulation, or other thereunder.

"(b) It shall be unlawful for any person without just cause to hinder, delay, or obstruct the making, filing, or keeping of any information, document, report, record, or account required to be made, filed, or kept under any provision of this subchapter and section 72 (a) and 107 (f) of Title 11 or any rule, regulation, or order thereunder. Aug. 22, 1940, c. 686, Title 1, section 48, 54 Stat. 846."

Section 80a-33 (b) provides:

"(a) It shall be unlawful for any person, except as permitted by rule, regulation, or order of the Commission, willfully to destroy, mutilate, or alter any [fol. 71] account, book or other document the preservation of which has been required pursuant to section 80a-30 (a) or 80a-31 (c) of this title.

"(b) It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this subchapter and sections 72 (a) and 107 (f) of Title 11 or the keeping of which is required pursuant to section 80a-30 (a) of this title. It shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading. For the purposes of this subsection, any part of any such document which is signed or certified by an ac-

countant or auditor in his capacity as such shall be deemed to be made, filed, transmitted, or kept by such accountant or auditor, as well as by the person filing, transmitting, or keeping the complete document. Aug. 22, 1940, c. 686, Title 1, section 34, 54 Stat. 840."

Stadia Oil & Uranium Co. v. *Wheelis*, 251 F.2d 269 (10th Cir., 1957) is cited in support. There purchasers of securities which were sold in violation of the 1933 Act sued one Rankin, a Vice-President and director of the corporation, among others and he denied participation. It was a jury question whether he was in "control" within the meaning of section 77a of the Act and under proper instructions the jury's verdict that he was in such control was sustained.

In *Hawkins* v. *Merrill Lynch et al.*, 85 F.Supp. 104 (W.D.Ark. 1949) also cited to the same point. It was held that where the defendant was sued and held liable for sales of securities in violation of the Exchange Act of 1934 directed another in such a manner as to violate the [fol. 72] rights secured by the legislation "there exists that degree of control necessary to create liability under section 78t (a)."

R. H. Johnson & Co. v. *Securities & Exchange Commission*, 198 F.2d 690 (2d Cir., 1952) also cited to the point. But we do not find that either of these three cases lend substantial support to appellees.

The Holding Company Act provision 79z-1 is the same as the Investment Act 80a-47. The Securities Act of 1933 has no comparable section. The Exchange Act of 1934 does have a comparable section 78t (b). Both the 1933 and 1934 Acts have sections making a person controlling any person who is liable under these Acts, jointly and severally liable with the controlled person (77o and 78t). The Investment Company Act has no such provision nor does the Holding Company Act. With respect to controlling persons the Investment Company Act indicates by its definition of "control" that the powers of control which inure to directors solely as the result of their official position in the company are not included in the word

"control" used in respect to provisions in the Act. The definition reads:

> "'Control' means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company."

Appellants insist and we agree that this wording of the Act shows that it was the legislative intent to refrain from entering the field of director responsibility. There is a sense in which it can be said as appellees have argued that directors control the various corporate actions of management on policy, but by this provision directors [fol. 73] acting in their official capacity are excluded from being held liable on that theory. As was stated in *Downing* v. *Howard*, 68 F.Supp. 6, 10, "At best, the alleged violations were violations by United. There is no provision in the Act imposing a duty or liability on officers or directors as such or upon outsiders acting in concert with officers and directors."

Appellees cite *Hooper* v. *Mountain States Securities Corporation*, ... F.2d ... (5th Cir., 1960) which was brought under the 1934 Act to recover on account of a fraudulent scheme concerted by defendants to have shares of stock issued for worthless property in order that the individuals could divide up the stock for their own use and get the benefits of their fraud. The court held the transactions to be within the purchase and sale provisions of the 1934 Act and the regulation. But on its facts the case does not have a bearing on the problem here in issue.

In *Taussig* v. *Wellington Fund, Inc.*, 187 F.Supp. 179 (D.C.Del. 1960) the controversy was between two investment companies both employing the name Wellington, which name was also used by the underwriters and advisors. The Court held the first investment company had the right to use the name Wellington and that use by the other was enjoined. Several provisions of the securities Acts were relied on to confer jurisdiction including 80a-34 (d) which makes it unlawful "for any unregistered investment company to adopt as a part of the name

or title of such company any word or words which the Commission finds and by order declares to be deceptive or misleading". It appeared to the Court that as the federal claim was not frivolous or a sham the Fund had standing to prosecute the action but there was no need to rule substantively on the federal causes.

[fol. 74] In *Aldred Mo. Trust* v. *Securities and Exchange Commission*, 151 F.2d 254 (1st Cir., 1945) the Commission sued under the Investment Company Act to enjoin the officers of an investment trust from continuing to act in such capacity and for the appointment of a receiver under 15 U.S.C.A. 80a-35 commonly referred to as the "gross abuse of trust" section. The case illustrates the instance in which the Act does deal with the matter of directors duty. It creates a right of action against directors to remove them from office for gross abuse of trust but it must be done on the initiative of the Commission. It furnishes no support for the liability of directors which Fund asserts on this appeal. In paragraph 1 and 2 on page 260, the Court refers to provisions of 15 U.S.C.A. Sec. 80a-1 (b) as effecting a codification of the fiduciary obligations imposed upon officers and directors of investment companies but the codification is of duties of the companies and the reference does not support a conclusion that Congress thereby created a federal cause of action in private individuals or by investment companies against their directors.

In *Cogan* v. *Johnson*, 162 F.Supp. 907 (S.D.N.Y. 1958) the plaintiff suing individually and as a stockholder of an investment company which had been deregistered by the Securities and Exchange Commission charged a continuing conspiracy by the company and its officers and directors to violate the 1940 Investment Company Act and with violations of the Act "in numerous ways". The relief sought was injunction against the continuing violations of the Act and injunction against the individual defendants preventing them from combining as officers and directors and for the appointment of a receiver to enable the company to comply with the Act. There was also a charge that the defendants [fol. 75] caused the company to violate the Act for their own interests and were guilty of gross abuse of trust as officers and directors.

The District Court held that the individual stockholders had no standing to bring an action based on the gross abuse of trust section, 15 U.S.C.A. 80a-35. The Court declared however that it did not "appear to a certainty that the plaintiff is entitled to no relief under any state of facts which may be proved in support of his claim" and denied the motion to dismiss.

The appellants say in reference to the *Cogan* case that if the holding there is that directors are liable for the facts of their corporation in violation of the 1940 Act, it is wrongly decided and should not be followed by this Court.

Respecting *Schwartz* v. *Bowman*, 156 F.Supp. 361 (S.D.N.Y., 1957) and related cases of *Breswick & Co.* v. *United States*, 134 F.Supp. 133 (S.D.N.Y., 1955), and *Breswick & Co.* v. *Briggs*, 135 F.Supp. 397 (1955) the federal case in *Schwartz* was violation by the Alleghany Railroad of the Investment Company Act by acquiring the New York Central stock without registering under the Act. The Court on appeal said a joint venture or conspiracy to cause C. & O. and Alleghany to engage in a transaction prohibited by the Act was charged. Appellants stress the contention that "there is a fundamental and critical distinction to be drawn between a case where a director is an actor and joint tort feasor in violating a statute and a case where the asserted liability is predicated upon vicarious liability for allegedly causing the corporation he serves to violate the statute". Because the Investment Company Act does not as do the 1933 and 1934 Acts create a joint duty and liability none can be implied to create a federal case. The [fol. 76] conspiracy in the *Schwartz* and *Breswick* cases distinguish them from the present appeal.

We do not find *Bell* v. *Hood*, 327 U.S. 678 (1945) to be relevant. The intent and effect of the decision as applied to the facts in that case were thoroughly considered by the District Court when the case was returned to it. 71 F.Supp. 813. The claim before the Supreme Court was that defendants had violated specified provisions of the federal law and Constitution. The doctrine of jurisdiction by implication where the federal statute has not imposed a duty was not discussed by the Supreme Court.

The District Court stated the rule it was required to follow, l. c. 820:

> "'Where, as here, neither the Constitutional provision nor any Act of Congress affords a remedy to any person, the mere assertion by a plaintiff that he is entitled to such a remedy' does not constitute a federal cause of action. . . .
>
> "In assuming jurisdiction under mandate of the Supreme Court, this Court is called upon to decide 'the issue of law . . . whether federal courts can grant money recovery for damages said to have been suffered as a result of federal officers violating the Fourth and Fifth Amendments.' . . .
>
> "Being of the opinion that neither the Constitution nor the statutes of the United States give rise to any cause of action in favor of the plaintiffs upon the facts alleged, I hold that federal courts cannot now grant such recovery. Nor does any other ground appear upon which relief can be granted to plaintiffs in this Court."

On consideration of the whole record and citations we conclude the claim stated against these appellants does not support the federal jurisdiction. At common law directors are liable to exercise due care and are not in- [fol. 77] surers, 13 Am. Jur. Corporation Sec. 990, p. 943-944. The complaints here substantially seek to hold these former directors to strict liability as insurers. The Act they rely on not only contains no such provision but plainly negates any intent to create such an innovation. The reliance upon implication to support the jurisdiction is not justified in the face of the legislative intent to exclude it.

In view of the conclusion that the motions for dismissal as to these appellants for lack of jurisdiction of the subject matter of the claim against them should be sustained, we need not discuss the question as to the out of the State service upon appellants, Rebstock and Rice.

Reversed with direction to dismiss the case as to these appellants.

[fol. 78]

IN UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 16566—September Term, 1960

J. JOHN BROUK, JAMES J. MULLEN, JR., W. MUNRO ROBERTS, JR., JEFFERSON J. REBSTOCK and EARL R. RICE; JACOB BAKER and GEORGE H. SHIELDS III, Appellants,

—VS.—

MANAGED FUNDS, INCORPORATED, a Corporation, EMANUEL JOSEPHSON and PROTECTIVE CASUALTY INSURANCE COMPANY.

JUDGMENT—January 13, 1961

Appeal from the United States District Court for the Eastern District of Missouri.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Missouri, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the Order of the said District Court overruling Motions to dismiss entered July 1, 1960, be, and the same is hereby, reversed with costs; and that J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, have and recover against Managed Funds, Incorporated, a Corporation, Emanuel Josephson and Protective Casualty Insurance Company, the sum of Two Hundred Forty and 65/100 ($240.65) Dollars for their costs in this behalf expended and have execution therefor.

And it is further Ordered by this Court that this cause [fol. 79] be, and it is hereby, remanded to said District Court with direction to dismiss the case as to appellants J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock, Earl R. Rice, Jacob Baker and George H. Shields III.

[fol. 80]

IN UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

(Title omitted)

ORDER DENYING PETITION OF APPELLEE FOR REHEARING—March 6, 1961

Appeal from the United States District Court for the Eastern District of Missouri.

The Clerk is directed to file the petition amicus curiae previously lodged by the Securities & Exchange Commission but the right of the Commission to participate as amicus curiae is denied since its application was not timely. The petition of appellee for rehearing has been considered by the Court and is hereby denied.

[fol. 81]

IN UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

(Title omitted)

ORDER STAYING ISSUANCE OF MANDATE—March 13, 1961

Appeal from the United States District Court for the Eastern District of Missouri.

On Consideration of the motion of appellee for a stay of the mandate in this cause pending a petition to the Supreme Court of the United States for a writ of certiorari, it is now here ordered by this Court that the issuance of the mandate herein be, and the same is hereby, stayed for a period of thirty days from and after this date, and if within said period of thirty days there is filed with the Clerk of this Court a certificate of the Clerk of the Supreme Court of the United States that a petition for writ of certiorari and record have been filed, the stay hereby granted shall continue until the final disposition of the case by the Supreme Court.

[fol. 82] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 83]

SUPREME COURT OF THE UNITED STATES

No. 947—October Term, 1960

MANAGED FUNDS, INCORPORATED, Petitioner,

vs.

J. JOHN BROUK et al.

ORDER ALLOWING CERTIORARI—June 19, 1961

The petition herein for a writ of certiorari to the United States Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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JAMES R. BROWNING, Clerk

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1960.

No. [redacted] 87

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1960.

No. .....

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit, entered in the above-entitled case on January 13, 1961.

OPINIONS BELOW.

The District Court overruled motions of certain defendants to dismiss the complaint. It did not file an opinion. The opinion of the Court of Appeals reversing the order of the District Court (App., *infra*, p. 29) is reported at 286 F. 2d 901.

JURISDICTION.

The judgment of the Court of Appeals (App., *infra*, p. 65) was entered on January 13, 1961. On February 1, 1961, petitioner filed in the Court of Appeals a petition

for rehearing or, in the alternative, for transfer to and consideration by the Court en banc. On February 6, 1961, motion of the Securities and Exchange Commission for leave to participate amicus curiae was filed. The petition for rehearing and the motion of the Securities and Exchange Commission were denied on March 6, 1961.

The jurisdiction of this Court rests on 28 U. S. C. 1254 (1).

QUESTIONS PRESENTED.

Petitioner, a mutual fund (registered as an investment company under the Investment Company Act of 1940*), sued its former investment advisers, sales companies, directors, and brokers in the United States District Court, for alleged violations of and breaches of duty created by the Investment Company Act of 1940, resting jurisdiction upon Section 44 of the Act giving the district courts jurisdiction of all causes of action to enforce any liability or duty created by the Act.

Respondents, who were certain of the defendant directors, moved to dismiss the action on the ground that there was no jurisdiction over the subject matter** for the assigned reason that there were no duties of directors created by the Investment Company Act of 1940, and hence no remedy against them cognizable in the Federal District

---

* The Investment Company Act of 1940 is set forth in Section 80a-1 et seq. of Title 15, U. S. C. The section numbers of 80a correspond to the section numbers of the Act until 80a-29, which is Sec. 30 of the Act, and from there on the corresponding section numbers of the Act are one digit above the section numbers set forth in 80a.

** Certain of the respondents, who were non-residents, also asserted that there was no jurisdiction over their respective persons, since they were served with process by extra-territorial service as authorized by Section 44 of the Investment Company Act of 1940. The District Court ruled against respondents on this phase of the motion. The Court of Appeals did not pass on this issue.

Court. These motions were denied by the District Court, and respondents appealed this order under the new interlocutory appeal section, Section 1292 (b), Title 28, U. S. C. The Court of Appeals reversed and remanded, directing dismissal of said respondents.

1. The first question presented is whether the Investment Company Act of 1940 imposes duties on the directors the breach of which gives rise to a civil cause of action by a fund against them in the District Court of the United States, under Section 44 of the Act.

2. If so, does petitioner's complaint, which avers that these respondent directors knowingly participated in violations of the Act and breached their own statutory duties created by the Act, state a claim against them within the broad liberality afforded a pleader under Rule 8 (a) of the Federal Rules of Civil Procedure?

STATUTE AND RULE INVOLVED.

The statute involved is the Investment Company Act of 1940, regulating the internal affairs and the investment advisory contracts of mutual funds,—more particularly, the following sections: Section 1 (b) declaring that the evils at which the Act is directed include "inside" operation by directors who are self-interested advisors, or by salesmen or underwriters having conflicts of interest, and to prevent operation of such funds for the profit of such insiders rather than for the investors; Sections 9 and 10 regulating the composition of boards of directors so as to limit the number of self-interested (affiliated) advisers and brokers or underwriters who may serve on such boards; Section 15 requiring initial approval of self-dealing contracts of advisers and underwriters by shareholders, and the extension thereof by shareholders or by disinterested (unaffiliated) directors; Section 8, (b) (2) requiring the management to declare the fund's fundamental policies for information

of investors, and Section 13 (a) (3) making deviation from such declared policies illegal.

Section 47 (b) declares that contracts made in violation of the statutory procedure are void, not merely voidable as in the case of "insiders" contracts at common law.

The jurisdictional section of the Act, Section 44, gives concurrent jurisdiction to State and Federal courts to enforce any liability for breach of duty created by the Act.

Rule 8 (a) of the Federal Rules of Civil Procedure is involved in the construction of petitioner's complaint.

These sections of the Act and the said rule are set forth in full in the Appendix, *infra*, beginning p. 67.

STATEMENT.

The District Court denied motions to dismiss the complaints in two actions, and these orders were reversed by the Court of Appeals on the grounds that there were no statutory duties of directors under the Investment Company Act of 1940 nor any legislative intent in enacting said statute to impose statutory duties upon directors, no remedy for breach, and that the complaints, which alleged a knowing participation by directors in violations of the Act, only asserted "insurers" liability.

These suits were filed after public disclosures in "Stop-order Proceedings" before the Securities and Exchange Commission in May of 1959.*

* The Commission, on July 31, 1959, entered an order prohibiting Fund from selling its stock, *In Re Managed Funds*, C. C. H. Fed. Sec. Law Rep., Current Par., 76,062 (1959), for the reason, inter alia, that the Fund was operating with an unlawful investment adviser. The S. E. C. made this finding regarding respondents (pp. 80, 509):

> "On the basis of the record it is evident that the directors failed to discharge their duties and responsibilities as directors, and failed to perform the functions which the prospectus represented they were performing."

The first suit was a derivative stockholders' suit instituted in the District Court in Delaware by Emanuel Josephson on behalf of Managed Funds, Incorporated, hereinafter sometimes referred to as the "Fund." The second suit was instituted by the Fund in the Eastern District of Missouri. The Josephson suit was thereafter transferred to the District Court for the Eastern District of Missouri and the causes consolidated.

Both suits were against the Fund's former investment advisers, sales companies, directors and brokers. The complaints sought to recover (1) unearned advisory fees in excess of $1,000,000 paid to the Fund's disclosed adviser, (2) brokerage commissions in excess of $1,500,000 paid to the Fund's undisclosed and unapproved adviser, for investment advice illegally rendered, and for brokerage transactions which were contrary to the Fund's stated and fundamental investment policy, and (3) the Fund's damage in making said payments and for losses resulting from excessive brokerage transactions. The accountability for the said monies paid and the damages incurred were based upon alleged violations of the Investment Company Act of 1940, and for breaches of statutory duty imposed thereby.*

Jurisdiction was based on Section 44 of the Investment Company Act of 1940 (80a-43 of Title 15, U. S. C.), which provides that the "district courts . . . shall have jurisdiction of violations" of the Act, and of "all suits in equity and actions at law brought to enforce any liability or duty created by, or enjoin any violation of" the Act.

The facts are set forth in the complaints and are confessed by respondents' motions.

* The Fund's complaint contains three other counts. Count II asserts liability for losses under the Securities Act of 1933; Count III raises liability for breaches of fiduciary duties, and Count IV seeks recovery on the claim of a conspiracy. Such counts may be joined with Petitioner's statutory claim. *Hurn v. Oursler*, 289 U. S. 238 (1933).

THE COMPLAINTS.

1. **The Parties.** The following is a list of the defendants:

Individual Slaytons (Hilton & Hovey)	Officers and directors of the Fund who also controlled or owned the Slayton Companies (R. 2).
Slayton Companies[**] Slayton & Co., and Mutual	"Underwriters" which sold the Fund's shares to the public, controlled by the Slaytons.
Slayton Associates	The Fund's designated investment adviser, owned by the Slaytons.
Directors (including Respondents)	Twelve former directors other than Slaytons, referred to in Fund's complaint as "outside directors."
Model, Roland & Stone	A partnership of 11 New York brokers.
Jaquith	Associated with brokers as investment adviser (R. 14).
Smith	Brother-in-law of defendant Hovey Slayton and employee of brokers (R. 3).
Stubbs	Former director of Fund and employee of brokers (R. 3).

** Slayton Associates, Inc., is hereinafter referred to as "Slayton Associates"; Slayton & Company, Inc., and Mutual Fund Distributors, Inc., are hereinafter referred to as "Slayton Sales Companies."

2. **Resumé of Facts Alleged in the Complaints.**

A. The Fund's unlawful investment advisers and the parties responsible for payments made to said advisers.

(1) Commencing August 15, 1952, and continuing until April, 1959, the Slaytons' advisory corporation, Slayton Associates, was awarded successive written contracts to act as the Fund's disclosed investment adviser (R. 4, 14).

This initial advisory contract was approved by the Fund's stockholders as required by Section 15 (a) of the Act. This written contract was, after August 15, 1954, extended each year throughout the period (R. 14) by defendant directors, including respondents. Under Section 15 (c) of the Act such contract could only be extended by a majority of the "unaffiliated directors."

Such advisory contract provided that Slayton Associates would render advisory, research and statistical services with reference to investments as were in accordance with Managed Fund's policies. Slayton Associates was paid by the Fund an annual fee in the amount of one-half of 1% of the Fund's asset value (R. 4), and said payments over the period totaled in excess of $1,000,000 (R. 15). This August 15, 1952, contract, effective throughout the period, provided that it was not assignable (R. 15) as required by the Act, Section 15 (a) (4).

(2) Commencing on December 1, 1953, and continuing until April, 1959, defendant Jaquith (the defendant brokers' investment adviser) assumed the duties of Slayton Associates, the above mentioned designated investment adviser for Managed Funds (R. 15). Slayton Associates, while still receiving the fee from the Fund, as set forth above, for purporting to perform advisory services, unlawfully delegated its duties to Jaquith and the defendant brokers (R. 16). This assignment violated the contract and rendered the service illegal.

(3) This assignment and transfer to defendant Jaquith of the advisory functions took the form of a ten-year contract, dated December 1, 1953, wherein defendant Jaquith was to use his best judgment in the selection, purchase and sale of securities for the Fund and was to be compensated in the form of minimum brokerage commissions with respect to the Fund's portfolio transactions directed to Jaquith's firm, the defendant brokers (R. 4, 5, 15).

(4) Neither the said contract of December 1, 1953, between Slayton Associates and Jaquith, nor Jaquith's assumption of the investment advisory function for Slayton Associates thereafter, was ever approved by the stockholders of Managed Funds (R. 7, 16), as required by Section 15 of the Act.

(5) Notwithstanding the assumption of the advisory function by the defendant brokers and the failure to have this relationship approved by the stockholders, the Slaytons and the directors, including the respondents, caused or permitted (R. 6, 19) the Fund to pay Slayton Associates in excess of $1,000,000 during the period for services that Slayton Associates did not perform (R. 16).

(6) During this same period, the same defendants caused the Fund to pay the defendant brokers and Jaquith in excess of $1,500,000 in brokerage commissions in payment for investment advice (R. 5).

(7) The complaints allege that such conduct was in violation of the Investment Company Act of 1940, since Slayton Associates unlawfully abdicated its function and defendants Jaquith and the brokers served and acted as investment advisers, without a written contract approved by the stockholders (R. 7). Section 80a-15 (a) provides that it is illegal to act as an investment adviser unless a written contract is approved by the stockholders of the fund. Subsection 15 (a) (4) requires automatic termina-

tion of stockholder-approved advisory contract upon its assignment. Aiding the remedy, both illegal contracts were expressly declared "void" under Section 47 (b), 80a-46 (b).

(8) Petitioner claimed it was a breach of the directors' duties under the Act [15 (c)] to approve a contract, and make payments thereunder, when the contract, by the provisions of the Act, had been terminated [15 (a) (4)] and was void [47 (b)]. It was a further breach of the directors' duties, under 15 (a) and (c) to operate, and to pay out money to the defendant brokers, under the unapproved and second illegal and void contract! Not only was it alleged that respondents did this, but it is alleged that they did it "knowingly" (R. 6, 19).

B. The Fund's deviation from its stated investment policy and parties responsible therefor.

(1) In accordance with the Investment Company Act, Section 8 (b) (2), the announced policy of Managed Funds, as set forth in its registration statements and prospectuses, was to provide for "capital growth", and to the extent consistent with such policy, to seek reasonable income on its investments, which net investment income and any realized profits on the sale of securities in its portfolio would be distributed quarterly (R. 4).

(2) After the defendant Jaquith and the broker defendants usurped the advisory function, the Fund's basic policy of "capital growth" was not followed (R. 5). Rather, a policy was followed in handling the Fund's portfolio so as to maintain a predetermined amount of distributions, and if income from portfolio investment was insufficient, to realize capital gains from the sale of the Fund's portfolio securities to pay these distributions (R. 5, 6).

(3) This policy, which respondents followed at the direction of the insiders (R. 6, 19), was a deviation from the stated policy of capital growth in that the Fund's portfolio securities were "churned", so that in 1958, as an instance, the rate of turnover of the portfolio securities was 98% as compared with 20% average in the trade (R. 16). This was likewise done without stockholder approval (R. 17).

(4) The policy which was followed resulted in gross mismanagement of and loss and damage to the Fund's portfolio (R. 6), in that the securities which had appreciated and had promise of more growth, were sold off and often immediately repurchased, whereas stocks which had unrealized depreciation were left in the portfolio. The portfolio was churned to realize capital gains so as to keep up an appearance of high "dividends", a sales feature exploited by the Slayton Sales Companies, who profited (R. 6).

(5) The policy of high turnover of the Fund's portfolio securities, resulted in a direct benefit to the defendant brokers and Jaquith (R. 6) who, as above stated, were also doubling as investment advisers and were being compensated in the form of brokerage commissions paid by the Fund on portfolio transactions (R. 5). The $1,500,000 paid said brokers was sufficient to enable them to pay, at the direction of the Slayton defendants, the defendant Smith, Hovey Slayton's brother-in-law, and the defendant Stubbs, the Slaytons' former business associate and former director of the Fund, in excess of $50,000 per year each, in commissions, when said defendant recipients did not perform any services in return for such payments (R. 5).

(6) Section 13 (a) (3) makes it unlawful to deviate from a fund's fundamental policy, stated under 8 (b) (2),

unless authorized by a majority of the fund's outstanding securities. The Managed Funds complaint alleged that the policy followed was thus illegal as being contrary to the Fund's stated policy (R. 7). Further, it is contrary to the policy of the Act, Section 1 (b) (2), for a fund to be operated, managed, and its portfolio securities selected, in the interest of directors, officers, investment advisers, brokers and dealers, rather than in the interest of all classes of security holders (R. 6).

(7) Petitioner claimed respondent directors had a duty under the Act not to permit and certainly not to participate in causing a deviation from fundamental policy, and that they were jointly liable for this violation and breach of statutory duty; the directors are in charge of the Fund's investment policy; the capital gains which were realized pursuant to the policy actually followed were distributed to stockholders by these respondent directors, who declared dividends; the distribution of these capital gains by respondents was part and parcel of the unlawful policy. These respondents knowingly participated, aided and abetted a plan whereby petitioner was operated in the interest of insiders rather than in the interest of the stockholders (R. 6, 19).

3. **Relief Sought.** The complaints sought not only an accounting for profits from those defendants who profited, but also sought damages from all defendants jointly liable, whose acts proximately caused damage to the Fund.

As above stated, the Court of Appeals reversed an order of the District Court overruling motions to dismiss.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

The case presents a question never before decided by this Court, namely whether there is a private right of action against directors for breach of any duty imposed upon them under the Investment Company Act of 1940.

This Federal statute regulates the internal affairs of mutual funds. It sets forth requirements as to the make-up of the boards of directors of such trusts and even provides a mandatory procedure to be followed in the execution and performance of insider contracts—the heart of this case. Yet, the Court of Appeals has ruled that directors, managers of a fourteen-billion dollar industry,* are not subject to liability under this Act.

The issue of director responsibility under this Act is a matter of grave public importance. The stock of these funds is being sold to persons all over the country. The stockholders are often small investors who seek the expertise of the management of these funds, and this is one of the inducements for such investment.

The Investment Company Act was passed to regulate certain inside dealings to which these trust funds were peculiarly susceptible. The responsibility of directors who are the shareholders' delegates—elected and given specific responsibility under the Act to control the self-interest of insiders dealing with the fund, is all-important.

This case brings up for decision the responsibility of directors for their knowing participation in violations of the Act and in permitting, aiding and abetting flagrant abuses by insiders and brokers of the Fund. More par-

* *Tanssig v. Wellington Fund, Inc.*, 187 F. Supp. 179, 197 (U. S. D. Ct., Del., 1960).

ticularly, petitioner submits that there are statutory duties imposed on directors to harness the basic conflicts of interest the law was designed to regulate, namely, self-dealing advisory contracts. Contrary to the ruling of the Court of Appeals, these duties are both expressed in the Act and implied from the manifest legislative intent in enacting the law.

Petitioner does not claim that these respondents are liable as "insurers", as the Court of Appeals seemed to construe the complaints. Nor does the Fund assert "vicarious liability" against respondents for the acts of others or for the Fund's own illegality. Petitioner's claim against respondents is based upon their own affirmative acts and omissions in violation of their own statutory duties, which acts and omissions aided and abetted the more active tortfeasors.

1. The Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this Court.

The Court of Appeals, in reversing the Trial Judge, has erroneously ruled (1) that the Act does not subject directors to liability, and (2) that the complaints aver only "insurers'" liability.

A. The Investment Company Act of 1940 does impose duties on directors, and they are subject to liability to the Fund for breach of such duties or for their causing a violation of the Act to the damage of the Fund. The District Court, therefore, had jurisdiction under Section 44 of the Act.

While this Court has not expressly ruled on the issue, the lower Federal Courts have held that there is a private right of action to persons damaged by violation of pro-

visions of the Securities Acts* even though a remedy or a right of action is not specifically given for the section violated.**

This is the doctrine of implying a remedy for violation of a statute. The cases have relied upon the decision of this Court in **Texas & P. R. Co. v. Rigsby**, 241 U. S. 33, 40 (1916), wherein the "inference of a private right of action" for violation of a Federal Statute was upheld to support Federal jurisdiction on the application of the maxim "*Ubi jus ibi remedium*".

The case of **Goldstein v. Groesbeck**, 142 F. 2d 422 (2d Cir., 1944), dealt with directors' liability (Electric Bond and Share) for violation of duty with respect to analogous sections of the Public Utility Holding Company Act. The court there held directors liable in a suit on behalf of their subsidiary corporation for amounts paid out under unregistered and, hence (by that Act), unlawful and void service contracts. That court, in ruling that the plaintiff stated a claim, said, on pages 425, 426:

> "Section 25, 15 U. S. C. A., § 79 y (identical to 80a-43), provides that 'any suit or action to enforce

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* Securities Act of 1933 and Trust Indenture Act of 1939 (Section 77 et seq. of Title 15, U. S. C.); Securities and Exchange Act of 1934 (Section 78 et seq. of Title 15, U. S. C. A.); Public Utility Holding Company Act of 1935 (Section 79 et seq. of Title 15, U. S. C.); and the Investment Company Act of 1940.

** Cases in the Second Circuit, *Baird v. Franklin*, 141 F. 2d 238 (2d Cir., 1944), *Goldstein v. Groesbeck*, 142 F. 2d 422 (2d Cir., 1944), and *Fischman v. Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir., 1951); the Third Circuit, *Slavin v. Germantown Fire Ins. Co.*, 174 F. 2d 799 (3d Cir., 1949); the Seventh Circuit, *Jung v. K & D Mining Co.*, 260 F. 2d 607 (7th Cir., 1958); the Ninth Circuit, *Pratt v. Robinson*, 203 F. 2d 627 (9th Cir., 1953), and *Errion v. Connell*, 236 F. 2d 447 (9th Cir., 1956); *Matheson v. Armbrust*, 284 F. 2d 670 (9th Cir., 1960); and recently by the Fifth Circuit, *Hooper v. Mountain States Securities Corp.*, 282 F. 2d 195 (5th Cir., 1960), c. d., October Term, 1960; and, more recently (since the instant decision), by the Sixth Circuit, *Dann v. Studebaker-Packard Corporation*, Par. 91,002, C. C. H. Federal Securities Law Reporter, Current (6th Cir., 2/6/61).

any liability or duty created by' the Act may be brought 'in the district wherein any act or transaction constituting the violation occurred' or 'in the district wherein the defendant is an inhabitant or transacts business.' The present action is surely to enforce a duty created by the Act, since but for the Act the payments under the service and construction contracts would be innocuous enough; and the words 'any liability or duty' are clearly broad enough to include any breaches of duty causing injury or loss to private persons."

. . . . . .

"Thus, the statutory declaration of the necessity for control of holding companies in § 1 (b) (2), 15 U. S. C. A., § 79a (b) (2), states, inter alia, that the national public interest is adversely affected 'when subsidiary public utility companies are subjected to excessive charges for services.' The three specific sanctions stated in the Act—injunction, § 18 (f), 15 U. S. C. A. § 79r (f); criminal punishment, § 29, 15 U. S. C. A. § 79 z-3; and the negative relief of § 26 (b), declaring the contracts void—do not in terms place the defrauded operating company in statu quo; and § 26 is incomplete, if not ineffective, unless it is considered to authorize recovery by the operating companies."

The above cited section of the Public Utility Holding Company Act [§ 26 (b)] is identical to Section 47 (b) of the Investment Company Act of 1940. This Act, like the Public Utility Holding Company Act, is much more than a disclosure act. It is a Federal Corporation Code, superimposed on state law, regulating the internal affairs of every corporation engaged in the mutual fund business.

There have been several District Court decisions all upholding a private right of action against persons, in-

cluding directors, who breach duties imposed by the Investment Company Act of 1940.* Prior to the instant decision, no case has ruled on either of the two clear statutory bases of liability involved in this suit. Since the decision in the Court of Appeals, the District Court of the Southern District of New York has held that there are statutory duties imposed upon directors under Section 15 of the Investment Company Act of 1940. In that case, **Brown v. Bullock,**** **C. C. H. Federal Securities Law Reporter,** Current, Par. 91,013 (S. D. N. Y., 1961), Judge Herlands said (p. 93,385):

> "This court is in respectful disagreement with the views expressed in the Brouk case to the extent that they restrictively interpret the 1940 Act."

1. **Section 15 (c) of the statute makes it *ultra vires* and illegal to "renew or perform" any advisory contract, oral or written, without approval of the contract by a majority of the "unaffiliated" directors.** The Court of Appeals exculpated these respondent "outside" directors and emphasized that they did not profit from the unlawful payments. This does not excuse them from joint liability, if their acts constituted a breach of a duty under the Act and contributed to cause this loss. This is the *ad damnum* feature of the case, as petitioner may not obtain complete satisfaction from the tort-feasors, who profited.

Not only do the provisions of the Act relied upon impose duties upon directors, but Subsection 15 (c) imposes a

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* *Schwartz v. Bowman*, 156 F. Supp. 361 (S. D. N. Y., 1957), appeal dismissed, Schwartz v. Eaton, 264 F. 2d 195 (2d Cir., 1957); the *Brestwick* cases: *Brestwick & Co. v. United States*, 134 F. Supp. 132, 138 (S. D. N. Y., 1955); *Brestwick & Co. v. Briggs*, 135 F. Supp. 397 (1955); *Brestwick & Co. v. United States*, 138 F. Supp. 123, 131, reversed on other grounds; *Alleghany Corp. v. Brestwick & Co.*, 353 U. S. 151 (1957); *Cogan v. Johnston*, 162 F. Supp. 907 (S. D. N. Y., 1958).

** The Second Circuit has recently permitted an interlocutory appeal from this decision.

specific duty on "unaffiliated" directors regarding the approval of advisory contracts. That section provides that it is "unlawful" for advisory contracts to be renewed or performed "unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party. . . .".

This section manifestly places supervisory duties upon those members of the board who are not affiliated with the adviser, to prevent the latter from making its own self-dealing, inside contracts. The statute contemplates that the unaffiliated directors are to be the "watch-dogs" for the shareholders in approving or disapproving (not rubber stamping) advisory contracts. These directors certainly have the duty not to extend, renew or pay out monies under a contract where the advisor-contractor is not doing the work and the contract is terminated by assignment under Section 15 (a) (4), and the relationship is void under the Act, 47 (b).

Here is what the Court said about the duties of directors under Section 15, in the post-decision case of **Brown v. Bullock**, supra, p. 93,375 of C. C. H. Federal Securities Law Reporter, Current:

> "The directors are thus charged by the Act with critically important powers and duties of a specific nature. Each year they must pass upon the extension of the investment advisory contract, unless they refer the decision to the stockholders; they (the directors) have the authority to terminate the contract 'at any time' on sixty days' notice; and, when the contract is made or is to be renewed, there must be a majority of the disinterested directors.
>
> "The grant of these defined powers, as specified by the Act, carries with it the imposition of corresponding

duties. The power to extend the investment advisory contract necessarily carries with it the duty to determine whether or not the extension is desirable and in the best interest of the company. The power to terminate the investment advisory contract necessarily carries with it the duty to keep alert for reasons which might make termination necessary or desirable; and, in the presence of such reasons, to exercise the right of termination. The objectives of the Act would be nullified if the directors were free to extend mechanically the contract without honestly exercising their best judgment. The objectives of the Act would be equally frustrated if the directors were free to close their eyes to any developments making the termination of the contract advisable.

"By giving the directors the right to extend and to terminate the contract, the Act necessarily also imposes upon the directors the fiduciary duty to use these powers intelligently, diligently and solely for the interests of the company and its stockholders. These specific fiduciary duties are created by the Act. Their violation subjects the directors to liability, which can be enforced in the federal courts under section 44 of the Act."

2. **Section 15 (a) makes it illegal under any circumstances to initially employ an adviser unless such contract is initially approved by shareholders.**

The Jaquith contract was made by the inside directors through their alter-ego, Slayton Associates. It was performed for five and one-half years without any approval of shareholders. The directors have a duty to require submission of such an advisory contract to the shareholders.

Section 15 added to every investment company charter a new *ultra vires* clause, concerning the requisite approval of advisory contracts. If directors exceed their powers as

defined by this statute, they are liable for losses or damages resulting from such unlawful and void advisory contracts.

If directors who know that advisory contracts of this kind must be approved by shareholders and that the shareholders have not approved such contracts, they are exceeding their statutory powers and thereby violating the duty imposed upon them by statute (not by common law) when they knowingly operate with such an adviser. The unapproved advisory contract was not only illegal, but void [Section 47 (b)]; the directors have a statutory duty not to pay out money under such a void contract.

3. **The Directors have a duty to require adherence by the Fund to its stated investment policy and not participate in causing a deviation from such policy.** There is another substantive regulation of investment companies manifestly aimed at management by the Board of Directors requiring declaration by the management of investment policies which were deemed fundamental [Section 8 (b) (2)], and making it illegal to deviate from such policy without approval of shareholders [Section 13 (a) (3)]. These sections which require adherence to stated policy are also new, substantive Federal regulations of such corporations. Fundamental investment policy is the function of the Board of Directors. The directors have a statutory duty to prevent or certainly not to cause or participate in causing a deviation from stated investment policy. The prohibition of the statute against fundamental change in the nature of the investment policy was not a mere common law prohibition. Violation was a breach of a statutory duty.

Legislative Intent. The Court of Appeals found there was no manifest legislative intent under the Act to imply statutory duties. They accepted cases cited by respondents where causation was not shown, or where the courts, in construing other acts, refused to imply a remedy be-

cause the duty breached ran in favor of a stockholder or investor.* The Court also determined legislative intention by making incorrect comparisons to other Securities Acts** and by its reference to only the construction of the legislative history referred to by respondents.*** Yet the Court, in considering this issue does not mention the express recitals contained in the Act itself.

These above-cited specific statutory sections are supplemented by the purposes stated in the Act and its legislative history, which clearly show a manifest legislative intent to imply director duties as to these particular violations. For example, the recital in Section 1 (b) (4) of the Act states that it is against the interest of the public and of investors, "when investment companies are managed by irresponsible persons". Clearly, this applies to the directors, implying not only a duty of vigilance, but certainly imposing a statutory duty not to aid and abet in the violation of the sections above mentioned.

Supplementing the above sections, prohibiting a deviation from stated policy, the recital in Section 1 (b) (6)

* *Hazard v. Farst*, 238 F. 2d 790 (2d Cir., 1956) Cert. denied, 353 U. S. 937; *Doyening v. Hazard*, 162 F. 2d 654 (3rd Cir., 1947); and *Birnbaum v. Newport Steel Corporation*, 193 F. 2d 461 (2d Cir., 1952).

** For example, the Court of Appeals said that the Investment Company Act of 1940 has no express provisions imposing liability on directors such as the section 16 (b) of the Securities and Exchange Act, 78p (b) of Title 15, U. S. C., prohibiting "insider profits". The Court was simply wrong here as there is a section of the Investment Company Act of 1940, Sec. 30 (f), 80a-29 (f), prohibiting insider profits of closed-end companies. (The stock of closed-end companies is traded other than redeemed as in the case of open-end compa[illegible]e there is no opportunity for insider profits.)

*** Respondents put great emphasis on the omission in the final draft of the bill of the provision in an earlier draft requiring registration of directors. But, such deletion was cured by the statutory qualification of directors specifically set forth in Section 9 of the Act.

of the Act announces a legislative intent to prevent investment companies from making any "change (in) the character of their business . . . without the consent of security holders". And Section 1 (b) (2) provides that investment companies are not to be "operated, managed, or their portfolio securities selected, in the interest of directors, officers, investment advisors . . . ."

Section 9 of the Act relates to the eligibility of directors, and Section 10 limits affiliated directors to 60% of the Board. At the hearings in the Congress when this bill was passed, a representative of the Securities and Exchange Commission stated that the requirement of 40% independent directors "is one of the most salutory provisions of this bill". (Hearings before the Sub-committee of the House Committee on Interstate and Foreign Commerce, H. R. 10065, 75th Congress, 3rd Sess., at 109 [1940].)

Space does not permit a full discussion of the significance of the Act's legislative history or other sections of the Act which show the legislative intent to impose statutory duties upon directors. Section 17 (h) (prohibiting exculpatory provisions as to the liability of directors), and Section 36 (sanctioning directors for gross misconduct or gross abuse of trust.) But again we refer the Court to the lengthy opinion in **Brown v. Bullock**, supra, where the Court gives a very learned treatment of the legislative history, which shows that the history of the Act supports rather than negates the liability of directors under the Act.

We agree with the Court of Appeals that this law was a compromise. There were those who wanted to outlaw completely self-dealing contracts.* The Act as passed per-

* Laretzki, The Investment Company Act of 1940, 26 W. U. L. Q. 303 (1941). Mr. Laretzki represented the closed-end companies in the negotiations.

mitted such contracts, but regulated the manner of approval and extension of such contracts. Such regulation carries with it corollary duties of the directors designated by the Act to control self interest. In addition, Congress provided that contracts made contrary to the regulations set forth in Section 15 were void and opened the door, by Section 44, to the Federal courts (as well as state) to recover damages for breaches of such duty.

B. The Complaints allege breaches of these duties by respondents to the damage of the Fund.

On a motion such as respondents', attacking jurisdiction, the rule is that the court should decide the case on the merits, whether plaintiff states a claim based upon the Constitution or Federal statute sued on, and such a complaint is sufficient unless the Federal question is "wholly unsubstantial or frivolous." **Bell v. Hood**, 327 U. S. 678 (1945);

The Court of Appeals has followed to the letter respondents' construction of petitioner's complaint, that it is "insurers liability." But, "'the party who brings a suit is master to decide what law he will rely upon.'" **Bell v. Hood**, supra, 681, quoting from **The Fair v. Kohler Die & Specialty Co.**, 228 U. S. 22 (1913). We have insisted all along that it is not insurers liability (liability without fault) which the Fund seeks to impose on respondents. Again, these directors were obligated by the Act to control particular self-dealing arrangements. This was **their** duty. The complaints allege that the directors knowingly participated, aided and abetted the insiders to violate the Act (R. 6, 19).

Here is what the **Josephson** complaint alleged (R. 19):

> "... that the directors of MF have approved, acquiesced in, ratified, committed and are committing the very wrongful, willful and illegal acts complained

> of herein, and the said directors are serving with the approval of, domination and control of the Slaytons and are beholden and completely subservient to their wishes, direction and control . . ."

This is not insurers liability, and we do not have to label respondents as "conspirators" as the Court of Appeals seems to imply.

Petitioner need only state a claim under Rule 8 (a) of the Federal Rules of Civil Procedure. On a motion to dismiss, the complaint "should be construed in the light most favorable to plaintiff" and such motion should be overruled "if it can reasonably be construed that the plaintiff can make a case upon trial." **Jung v. K & D Mining Co.**, 260 F. 2d 607 (7th Cir., 1958). In determining the sufficiency of a complaint, the accepted rule is "that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." **Conley v. Gibson**, 355 U. S. 41, 45, 46 (1957).

The Fund's complaint alleged that defendants, including respondents, had knowledge of the provisions of the Act (R. 4). It is specifically alleged that all defendants, including these respondents, "committed, or with actual or constructive knowledge, . . . aided, abetted, acquiesced in or condoned, directly or indirectly", the said violations of the Act (R. 6). The defendant directors "committed" the acts complained of (R. 19).

These allegations tie in directly to show a breach of the above statutory duties by respondents.

1. These respondents knowingly approved contracts for advisory service each year for five years, with a corporation which they knew was not performing the serv-

ices for which it was being paid, which had abdicated and illegally assigned its contract to the brokers. Slayton Associates (the alter-ego of the inside directors) was employed by the Fund as the disclosed investment adviser "pursuant to successive written contracts . . ." from August 15, 1952, and continuing until the date of the commencement of this action (R. 14). The outside directors' affirmative acts in knowingly renewing the lucrative contracts with this shell corporation were positive breaches of their statutory duty. These affirmative acts permitted the payment of over $1,000,000 for services which were not rendered. But for such approval, required by Section 15 (c), there would have been no authority for such payment.

2. At the same time the respondents approved the above contracts, they knowingly permitted the Fund to operate with a broker-adviser whose contract was not disclosed or approved by stockholders nor formally approved by themselves. They are alleged to have aided and abetted in the paying out of over $1,500,000 to the brokers under this second unlawful contract.

3. It is alleged that "the acts of the defendants have violated the primary and principal policy of 'capital growth'" (R. 16). The complaints specify that what was done was to churn the portfolio and to distribute the capital gains (dividends)—a function of the board of directors (R. 16). This was for the benefit of the "insiders" (R. 5). The policy followed by these directors resulted in gross "mismanagement" to the benefit of the insiders (R. 6).

The Act imposes statutory duties on directors. Petitioner's complaint alleged breaches of these duties by respondents and the Trial Court, therefore, properly ruled that it had jurisdiction.

II. **The decision which the Court of Appeals has rendered is in conflict with the Court of Appeals for the Second Circuit on the same matter, namely construction of parallel sections of the Public Utility Holding Company Act and the Investment Company Act of 1940.**

The decision rendered by the Court of Appeals is in conflict with **Goldstein v. Groesbeck**, *supra*, 142 F. 2d 422 (2nd Cir., 1944). While the **Goldstein** case was decided under the Public Utility Holding Company Act, the case dealt with liability for monies paid under service contracts which were unlawful under that Act. The court there effectuated the Congressional intent of that Act and the substantive section of that law declaring unlawful contracts void.

Although the **Goldstein** case does not deal with as many or as flagrant violations of the law as are present here, the complaint there was held sufficient against the directors therein sued. Nor did it appear in that case that the directors participated in the violations charged, other than being directors of Ebasco.

Yet the Court of Appeals here has sought to distinguish **Goldstein**, p. 914 of 286 F. 2d, by saying that plaintiff in **Goldstein** sought profits "gained by the construction and service corporation and certain of their officers and directors." But there is nothing in the decision in that case to indicate that the directors of Electric Bond and Share Company, or Ebasco, profited. Rather, the action in **Goldstein** was "to account for profits received by Ebasco" (142 F. 2d 424). It would appear then that the directors were subjected to joint liability.

The Court of Appeals also attempted to distinguish **Goldstein** in that the "void contract theory requires privity." But in **Goldstein** there was no privity of contract as to the directors there sued.

The Court of Appeals, p. 914, 915 of 286 F. 2d, also cited 15 U. S. C. A., 78cc (b), being the 1938 amendment of the void contract section of the Securities and Exchange Act of 1934, and quoted said section, containing a statute of limitations, as if this section somehow distinguished **Goldstein** from the instant case. Said limitations are **not** contained in the void contract section (Sec. 79z) of the Public Utility Holding Company Act, relied on in **Goldstein**. The Court in **Goldstein** cited the section of the Exchange Act not as as obstacle but as additional reasoning supporting a Congressional intent to create a civil liability of directors.

The "void" section of the Holding Company Act (79z) was an important section relied on in **Goldstein** supporting its decision, as quoted by this Court, Opinion, p. 28. Said Section 79z is identical to the void contract section of the Investment Company Act, 47 (b), and it would appear, therefore, that the **Goldstein** case is a clear precedent here, and that the void contract section of the Exchange Act containing a limitation, could hardly be support for denying liability here or an indication of a Congressional intent (by the absence of a limitation) to make 47 (b) a nullity.

Conclusion: The issue here is neither non-feasance nor mere negligence. The issue here is liability of directors for irresponsible violation of law in the management of other people's money. Even when they do not directly profit by the unlawful operation, they have lent their names to the enterprise and must be held to have accepted the responsibility and duties specifically imposed by the statute. As joint tort feasors, they must be held to respond in damages if they violate the very provisions of the law which they are appointed to enforce, wherever such violation of duty causes losses to the investors.

The Court of Appeals overlooked new standards of responsibility for both inside and disinterested directors, new duties in safeguarding and preventing self-dealing

operations. The action against these directors is for damages. The Fund must, of course, prove damages proximately caused by respondents' breach of statutory duty. For such damages petitioner should be entitled to recover from respondents. That is why Congress made illegal the corporate acts approved by these directors and created a new substantive law, voiding inside contracts. Is there no remedy against the managers who violated this Act?

Some of the directors are located in various parts of the country and this is why the Congress included in Section 44 the long arm provision for service of process. Such a case should be tried in a Federal tribunal with all joint tort-feasors before the Court. A body of Federal law should evolve construing this Act. **Textile Workers Union v. Lincoln Mills**, 353 U. S. 448 (1957).

For all of the foregoing reasons, it is respectfully submitted that this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX A.

(Opinion Below.)

UNITED STATES COURT OF APPEALS
For the Eighth Circuit.

No. 16,566

J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr. et al., Appellants,

vs.

Managed Funds, Incorporated, et al., Appellees.

Appeal from the United States District Court for the Eastern District of Missouri.

[January 13, 1961.]

Before Woodrough, Van Oosterhout, and Matthes, Circuit Judges.

Woodrough, Circuit Judge.

These appeals are taken from an order of the District Court which denied motions made by appellants to dismiss for lack of jurisdiction of subject matter or person or both in two actions brought against appellants and others by Managed Funds Incorporated and by one Emanuel Josephson. The actions had been consolidated and the order determined that the motions to dismiss the complaints for want of jurisdiction involved a controlling

question of law upon which there is a substantial ground for difference of opinion and that an immediate appeal from the Court's order may materially advance the ultimate determination of the litigation. Pursuant to application to this Court to appeal under Section 1292(b), 28 U.S.C.A., the appeals were allowed to review the District Court's ruling on the motions to dismiss as related to the claims asserted against these appellants and the denial of appellants' motion to dismiss on jurisdictional grounds.

The plaintiff Managed Funds Incorporated, is a registered open end investment company within the purview of the Investment Company Act of 1940 (54 Stat. Sec. 798-847; 15 U.S.C.A. 80(a) et seq.) Prior to the commencement of the present actions a stop order proceeding was had against it before the Securities and Exchange Commission under Section 8(d) of the Securities Act and a stop order was issued by the Commission upon extensive findings. In re Managed Funds Inc. Par. 76,662, C. C. H. Federal Securities Law Reporter, Current.

The general object and nature of the present consolidated actions is an accounting, injunction and recovery of money damages by Managed Funds for alleged violations of the Investment Company and the Investment Advisers Act of 1940 which are in general the same violations found by the Commission.

The *Josephson* case is a stockholders' derivative action prosecuted for and on behalf of Managed Funds, Inc., but in which Managed Funds, Inc., is named as a defendant. The *Managed Funds* case is a direct action by the corporation itself embracing the same general factual background.

Emanuel Josephson filed the derivative action in the United States District Court, District of Delaware. Managed Funds, Inc., filed its action in the United States District Court, Eastern District of Missouri.

Defendants, Hilton H. Slayton and Hovey E. Slayton, were officers and directors of the fund and owned or controlled defendant, Slayton Associates, Inc., the Funds' Investment Adviser and defendants, Slayton and Company, Inc. and Mutual Fund Distributors, Inc. which were engaged in the selling of Funds' shares. Defendant, Model, Roland & Stone, is a stock brokerage partnership composed of the individual defendants indicated. These appellants and defendants, Boas, Cunningham, Hicks, Jester, Shields and Stubbs are former members of the Board of Directors of Managed Funds, Inc.

The Josephson complaint rests jurisdiction on the claimed violation of the Investment Company and Adviser's Act of 1940, and rules of the Securities and Exchange Commission promulgated thereunder. Managed Funds' Amended Complaint rests jurisdiction on alleged violations of the Investment Company Act of 1940 and rules of the Securities and Exchange Commission promulgated pursuant to it.

Appellant, Jefferson J. Rebstock, and appellant, Earl R. Rice, are citizens and residents of the State of Louisiana. They appeared specially and by motions sought dismissal of the four counts of Funds' amended complaint for lack of jurisdiction of both subject matter and person. Appellants, W. Munro Roberts, Jr., J. John Brouk and James J. Mullen, Jr., are citizens and residents of the State of Missouri. They moved to dismiss for lack of jurisdiction of subject matter. Like motions were filed respecting the Josephson complaint and the adoption thereof by Protective Casualty Insurance Company. Simila, motions were filed by all appellants on this appeal.

These appellants and some other directors are denominated by Fund in the Amended Complaint as "outside directors", that is directors alleged to have had actual or constructive knowledge of the alleged wrongful acts of the

Slaytons individually and the Slayton Companies and broker defendants.

The facts pleaded in Count I of Funds' Amended Complaint are substantially as follows:

That the plaintiff, Managed Funds, Incorporated, is a registered open end investment company under the Investment Company Act selling its shares to the general public through underwriters, distributors, dealers and salesmen. That Fund entered into a contract with Slayton Associates, Inc., whereby it became "Funds' Investment Adviser" for agreed compensation of ½ of 1% of the asset value of Funds' asset portfolio, consisting of shares of common stock of various companies. That in December of 1953, Slayton Associates, Inc. employed defendant, Jaquith, as investment counselor and manager of Funds' securities portfolio and delegated its duties as investment adviser to defendant, Jaquith; that Slayton Associates, Inc., agreed to pay Jaquith, $50,000.00 a year for five years beginning in December of 1953, and a minimum of $35,000.00 a year for the next succeeding five years, which payments were to be applied against brokerage commissions Jaquith or his designees would receive respecting Funds' brokerage business channeled to Jaquith; that Jaquith channeled Funds' business to the stock brokerage partnership of Model, Roland and Stone, defendant herein, of which Jaquith was a member, whereby such partnership received brokerage commissions of over $1,500,000.00; that Jaquith and Model, Roland and Stone paid $50,000.00 a year to defendants Smith and Stubbs, for which no services were performed, it being averred that Stubbs is a former business associate of the Slaytons and an employee and representative of Model, Roland and Stone, a former director of the Fund; that defendant, Smith, is also an employee and representative of defendant, Model, Roland and Stone, and a brother-in-law of defendant, Hovey E. Slayton.

That Funds' announced policy in offering its shares as contained in reports and prospectuses filed with the Securities and Exchange Commission was to provide for capital growth and reasonable income consistent therewith by realized profits on the sale of portfolio securities and dividends; and to make quarterly distributions to its shareholder; that after the arrangement with Jaquith, it is averred this policy was not followed, and distribution to shareholders were made of a predetermined income to meet which it was required that capital gains be realized, thereby permitting defendants, Slayton and Company, Incorporated, and Mutual Fund Distributors, Incorporated to make greater commissions and profits from the sale of Funds' shares. This policy, it is averred, resulted in mismanagement, loss and damage to Funds' investment portfolio by increased brokerage commissions for purchase and sale of portfolio securities and greater payments to Jaquith by Slayton Associates, Inc.; that Fund was caused to place its brokerage business for the sale of portfolio securities with brokers who also sold Funds' shares, and with brokers who rendered services to Slayton Associates, Inc., and to Slayton and Company, Inc., and Mutual Fund Distributors, Inc. seller and distributor of Funds' shares to satisfy obligations of companies for services rendered to them.

By paragraph 21 of Count I of the Funds' amended petition, it is averred that:

> "The defendants committed, or with actual or constructive knowledge, as herein above set forth, aided, abetted, acquiesced in or condoned, directly or indirectly, violations of the Investment Company Act of 1940."

by (a) operating the fund in the interest of directors, etc., rather than Funds' security holders, [15 U.S.C.A. 80a-1 (b)2] caused Fund to publish and circulate documents

containing untrue statements or omitting material facts, [15 U.S.C.A. 80a-33]; (c) caused Fund to deviate from a fundamental investment policy, [15 U.S.C.A. 80a-13] and (d) that defendants, Model, Roland and Stone and Jaquith, acted as investment advisers without a written contract approved by the outstanding voting securities of Fund. [15 U.S.C.A. 80a-15(a)]

Count II of Funds' Amended Complaint avers that the Court has jurisdiction of Count II because it is based on the same acts alleged in Count I of which the Court has jurisdiction under the Investment Company Act. And it is averred that Fund may be liable to purchasers of its shares by reason of the defendants having caused Fund to file false registration statement required by the Securities Act of 1933; that the Securities and Exchange Commission issued a stop order and that Funds' name and good will were damaged, and that Fund expended money for counsel fees and other expenses in connection with the Securities and Exchange proceedings.

Count III bases jurisdiction on the same grounds as Count II and avers that Slaytons individually occupied a fiduciary relationship with Fund as Funds' President and Vice-President; that Model, Roland and Stone and Jaquith acted as investment advisers and therefore occupied a fiduciary relationship; that each of the other defendants had actual knowledge of the fiduciary relationship of the Slaytons to the Fund, and constructive knowledge of the fiduciary relationship of Model, Roland and Stone and Jaquith to the Fund; that the Slaytons and Model, Roland and Stone breached their fiduciary duties, committed waste and mismanaged Fund, and all except for the "outside directors" profited thereby; that all defendants, including the "outside directors" by reason of actual knowledge or constructive knowledge of the fiduciary relationships of the Slaytons and Model, Roland and Stone to Fund are liable for their acts.

Count IV adopts the allegations of Count I except paragraphs 20, 21 and 22 and paragraphs 3 through 6 of Count III, and avers a conspiracy between all defendants, except the "outside directors" who, it is averred, had actual or constructive knowledge and failed to do anything to prevent the actions of the other defendants, and are therefore liable to Fund.

Prayer of each of the Counts is for money damages, and for an accounting for profits as to all defendants.

The Josephson complaint recites the same basic facts as Count I of Funds' Amended Complaint and the same violations by Fund, and avers that "the wrongful acts herein described have been and continue to be committed by the defendants against Managed Funds in breach of legal and fiduciary obligations that are inherent by reason of the relationship of the parties". Josephson prays for an injunction in addition to an accounting and damages.

The District Court of Delaware transferred the *Josephson* case to the United States District Court, Eastern District of Missouri and the cases were consolidated.

Pursuant to an order entered by the District Court, the Protective Casualty Insurance Company, a corporation, was allowed to intervene as a party plaintiff in the *Josephson* case. The Protective Casualty Insurance Company, as an intervening party, adopted the complaint of Emanuel Josephson as its complaint.

On July 1, 1960, the District Court, by its order, denied each and all of the appellants motions to dismiss for lack of jurisdiction of subject matter and or person.

The points presented by appellants for reversal of the order are: 1. That the Investment Company Act of 1940 does not expressly or by implication create any statutory duty or liability respecting directors of an investment company, the violation of which gives rise to a cause of

action by such investment company against these directors which is within the jurisdiction of the District Court of the United States. 2. Mere violations of the federal statute does not as a matter of general law create a case of which Federal Courts have jurisdiction and the theory of federal jurisdiction by implication has been rejected in security cases where corporations have sought to hold directors for claimed statutory violations and mismanagement or breach of duty. 3. The legislative history of the Investment Company Act of 1940 discloses a complete lack of congressional intent to create a body of federal law respecting liability of directors of investment companies.

In support of the first point appellants recall that the Federal Courts are not courts of general jurisdiction but are courts of special or limited jurisdiction in that they have no jurisdiction except that conferred by the Constitution and laws of the United States, 54 Am. Jur. United States Courts Sec. 10, p. 671 and that:

> "A suit to enforce a right which takes its origin in the laws of the United States is not necessarily, or for that reason alone, one arising under those laws, for a suit does not 'arise' unless it really and substantially involves a dispute or controversy respecting the validity, construction or effect of such a law, upon the determination of which the result depends." *Gully* v. *First National Bank*, 299 U.S. 109, 114.

Appellants point out that neither complaint here involved attempts to base jurisdiction on any federal statute other than the Investment Company Act and the Investment Adviser's Act of 1940 and that the claim of jurisdiction to be sustained must fall within the category of a right created by the act of Congress whereby jurisdiction is conferred upon the Federal Courts without regard either to diversity of citizenship of the parties or the amount in controversy.

The Investment Company Act of 1940, 15 U.S.C.A. 80a-1-52, and the Investment Advisers Act of 1940, 15 U.S.C.A. 80b-1-21, are the fifth in a series of six Congressional enactments relating to securities. The Securities Act of 1933, 15 U.S.C.A. 77a-77aa, the Securities Exchange Act of 1934, 15 U.S.C.A. 78a-jj, the Public Utility Holding Company Act of 1935, 15 U.S.C.A. 79a-z and the Trust Indenture Act of 1939, 15 U.S.C.A. 77aaa-77bbb each contain express provisions for private civil actions. See, 77k, 77l, 78i(e), 78r, 79p, and 77www. Directors may be sued under 77k. Under 78p(b) insiders profits may be recovered by an "issuer", or if it refuses to sue, through a security holder of an issuer in its name. There are provisions for limitations, joint liability and rights of contribution, 77m, 77k(l), 78aa and 77k. By contrast neither the Investment Company Act nor the Investment Advisers Act of 1940 contain any such provisions. The Investment Company and Advisers Acts neither make any definition of the duties of directors nor provide anywhere that a registered investment company may sue its directors.

Respecting jurisdiction of the District Courts, the Investment Company Act provides:

> "Sec. 80a-43. Jurisdiction of offenses and suits
>
> The district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter and sections 72 (a) and 107 (f) of Title 11, or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and sections 72 (a) and 107 (f) of Title 11 or the rules, regulations, or orders, thereunder. Any criminal proceeding may be brought in the district wherein any Act or transaction constituting the viola-

tion occurred. A criminal proceeding based upon a violation of section 80a-33 of this title, or upon a failure to file a report or other document required to be filed under this subchapter and sections 72 (a) and 107 (f) of Title 11, may be brought in this district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and section 72 (a) and 107 (f) of Title 11 or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in section 225 and 347 of Title 28 and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter and section 72 (a) and 107 (f) of Title 11 brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title I, Sec. 44, 54 Stat. 844."

The Advisers Act provides:

"Sec. 80b-14. Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceedings may be brought in

the district wherein any suit or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business, or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in section 225 and 347 of Title 28, and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title II, Sec. 214, 54 Stat. 856."

The jurisdiction section of the 1933 Act, 15 U.S.C.A. 77v, the Public Utility Holding Company Act, 15 U.S.C.A. 79y, and the Trust Indenture Act, 15 U.S.C.A. 77vvv, are substantially the same as 80a-43. The Exchange Act provides that the United States Courts have "exclusive jurisdiction" to enforce liabilities or duties created by that Act. 15 U.S.C.A. 78aa.

The express wording of the Investment Company Act above is that criminal jurisdiction for violations is exclusively in the District Courts of the United States and civil jurisdiction is concurrently in State Courts and Federal Courts "of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter * * *". The Advisers Act confers jurisdiction of violations and suits to enjoin violations, and says nothing about duties or liabilities of directors.

The absence of specific language creating civil liability respecting private actions narrows the jurisdictional question presented by this appeal to whether or not directors' liability to registered investment companies which they serve has been created by implication.

Under some of the federal legislation relating to security transactions federal jurisdiction of private actions has been upheld by implying a right of action respecting contracts declared void by the statute and by implying a right of action for damages in tort for violation of the federal statute.

Appellants recognize that the doctrine is well supported that a cause of action within the federal jurisdiction exists by implication in the security field in suits brought by purchasers of securities against sellers or by sellers against purchasers on account of violations more particularly under the 1933 and 1934 Acts. The record of the development of the doctrine is shown in the Annotation to *Fratt* v. *Robinson*, 203 F.2d 627, (1953) in 37 A.L.R. 2d 649 and it appears that the jurisdiction has been implied first under the general provisions of the Exchange Act, the Holding Company Act and the Investment Company and Investment Advisers Act to the effect that contracts in violation of the Acts or rules thereunder are void. The applicable Investment Company Act provision is as follows:

"Section 80a-46. Validity of contracts.

(a) Any condition, stipulation or provision binding any person to waive compliance with any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or with any rule, regulation, or order thereunder shall be void.

(b) Every contract made in violation of any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or of any rule, regulation, or order

thereunder, and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, regulation, or order. Aug. 22, 1940, c. 686, Title 11, Sec. 47, 54 Stat. 845."

The second basis of liability, is "the common law tort doctrine of private action based on violation of a statute".

It is the position of appellants that the void contract theory of liability and the theory of tort liability based on violation of a federal statute has been rejected by the courts in situations where director liability to their corporation has been involved. Further, that the legislative history of the Acts here involved shows a complete absence of any legislative intent to create such private actions against directors by investment companies cognizable in the Federal Courts.

The appellants refer to the case of *Kardon* v. *National Gypsum Co. et al.*, (D.C.E.D. Pa., 1946) 69 F.Supp. 512, as the root case containing judicial pronouncement of the two theories on which federal jurisdiction has been implied.

This was a fraud case under the Exchange Act of 1934 to recover damages against the National Gypsum Com-

pany and others for inducing plaintiffs to sell their stock in two corporations for less than true value. The court was ruling on motions of defendant to dismiss for lack of jurisdiction of person and failure to state a claim. By Rule X-10B-5 implementing 78j, the Security Exchange Commission made it unlawful for any person to employ deceptive devices in the purchase or sale of securities. The Court stated the question was whether the conduct complained of gave rise to a liability or involved a breach of duty created by the 1934 Act and then held:

> "It is not, and cannot be, questioned that the complaint sets forth conduct on the part of the Slavins directly in violation of the provisions of Sec. 10 (b) of the Act and of Rule X-10B-5 which implements it. It is also true that there is no provision in Sec. 10 or elsewhere expressly allowing civil suits by persons injured as a result of violation of Sec. 10 or of the Rule. However, 'the violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if; (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is intended to protect. * * *'. Restatement, Torts, Vol. 2,, Sec. 286. This rule is more than merely a canon of statutory interpretation. The disregard of the command of a statute is a wrongful act and a tort."

The court also predicated liability on the void contract-theory saying:

> "Apart from Sec. 10 (b), I think that the action can also be grounded upon Sec. 29 (b) of the Act which provides that contracts in violation of any provision of the Act shall be void. Here, unlike the point just discussed, the question is purely one of statutory construction. It seems to me that a statutory enactment

> that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it. The statute would be of little value unless a party to the contract could apply to the Courts to relieve himself of obligations under it or to escape its consequences. Beyond this, however, as pointed out by Judge Coxe in *Geismar* v. *Bond & Goodwin, Inc.*, D.C., 40 F.Supp. 876, 878, the 1938 amendment which deals in part with actions 'maintained in reliance upon this subsection' clearly contemplates that Congress meant the original statute to be interpreted as providing for civil suits under it. And, as he further pointed out, such suits would include not only actions for rescission but also for money damages."

It is significant that in speaking of the void contract theory the court says a *party* may be relieved of contract obligations induced by violations and appellants insist that the Security Act provisions voiding contracts in violation of the Acts can apply, only where plaintiff and defendant in an action for relief under the Acts are in privity of contract or perhaps where plaintiff can work out a third party beneficiary relationship. None of appellants here are parties to the advisory contract between Associates and Fund or the contract between Associates Jaquith and Model, Roland and Stone. They say they can not be brought within the doctrine of *Kardon* v. *National Gypsum Co. et al.*, supra. Furthermore, that the defendants in the action were the ones charged with violating the Acts was conceded in *Kardon*, whereas appellants contend the complaints here charged no statutory duties or liabilities respecting directors which these directors have violated.

2.

Under their second point appellants contend that the courts have rejected implication of federal jurisdiction in director liability cases. They cite *Howard* v. *Furst* (2d

Cir. 1956) 238 F.2d 790, aff'd, S.D.N.Y. 140 F.Supp. 507. That was a derivative suit on behalf of Circle Wire & Cable Corporation against officers and directors of Circle who held over 60% of Circle's shares. There was no diversity. Federal jurisdiction was asserted under the Exchange Act of 1934, Section 78aa. The complaint alleged that Circle had an agreement to sell and a Cerro de Pasco Corporation an agreement to buy Circle's property and business for over twenty million dollars; that the individual defendants to advance their own private interest negotiated the sale for less than the value of the assets of Circle; that the sale would constitute a waste of Circle's assets; that the directors by virtue of their position and as controlling stockholders of Circle abused their fiduciary obligations. That a proxy statement of Circle's shareholders meeting to vote upon the sale was false and misleading, in that it understated the cost and value of Circle's inventory and its earnings and failed to disclose the private interests of the officers and directors of Circle. Section 78n (a) made it unlawful to solicit proxies by use of the mails in contravention of rules of the S.E.C. and by Rule X-14A-9 the S.E.C. had proscribed false or misleading material in proxy statements. The prayer for relief was to declare the proxies void; to enjoin certain individual defendants from voting, to declare the sale contract void, and to rescind it and restore the status quo and alternatively, if this be impossible, that Circle recover damages from Cerro and the individual defendants directors of Circle. In summing up the complaint the Court said: "In other words, appellant asserted a claim for an injunction against the sale, which, now that the sale has gone through, has become a claim for rescission or for the damages suffered by Circle, not by appellant". The Court sustained the action of the District Court, S.D.N.Y. 140 F.Supp. 507, dismissing the complaint for lack of jurisdiction of the subject matter, Circuit Judges Hand, Medina, and Hincks sitting. The Court said:

"As the case is said to be one 'arising under' the laws of the United States, our first inquiry is addressed to appellant's contention that the statutory provisions above quoted create or give rise to a substantive civil right on behalf of Circle, which may be enforced in a derivative action by an individual stockholder. We reject this contention as unsound. We find nothing in the language of Section 14 (a) or in the legislative history of the Securities Exchange Act of 1934 to warrant an inference that it was the intention of the Congress to create any rights whatever in a corporation whose stockholders may be solicited by proxy statements prepared in contravention of the statutory mandate."

The Court pointed out that where the 1934 Act created a corporate action for insider profits this was done by an express provision 15 U.S.C.A., Sec. 78p (b). Applying the federal right test of the *Gully* case, supra, the Court said:

"Applying this test it is clear to us that every essential element of appellant's case depends upon the common law and the statutes of the state of New York. If the individual defendants who controlled 60.68% of Circle's outstanding stock, in violation of their fiduciary duties as directors and officers of Circle, brought about a sale of Circle's assets for a grossly inadequate sum, all in furtherance of their personal and private interests, the case would be ripe for judgment for rescission of the sale or for damages, wholly irrespective of whether some or all of the individual defendants had participated in the formulation and sending out of a false or misleading proxy statement. The allegations with reference to the proxy statement constitute a mere excrescence or superfluity tacked onto what are otherwise sufficient allegations of a claim for relief under New York law."

Appellants also cite *Downing* v. *Howard*, 162 F.2d 654 (3rd Cir. 1947), aff'd, 68 F.Supp. 6 (D.D.C. 1947). The nature of the action is described by the Court as follows:

> "Plaintiff is the owner of shares of United Corporation (of Delaware), hereafter called United. He brought this action in the United States District Court for the District of Delaware on behalf of himself, other shareholders of United, and the Corporation against individuals or, in some instances, their personal representatives, who had been directors of United and certain other persons alleged by plaintiff to have conspired with the directors to the detriment of the Corporation. Most of the individual defendants are neither residents of Delaware nor engaged in business there. Plaintiff, however, says that he is properly in the federal court under Sec. 25 of the Public Utility Holding Company Act of 1935. He concedes that unless he has stated a cause of action 'created' by that statute his action in the District Court of Delaware will not lie."

By the third count it was claimed the directors failed to file with the SEC a plan of reorganization. The Court held:

> "The fatal obstacle to the plaintiff's complaint on this score is that the legislation does not require the company to furnish a plan. A cause of action can hardly be based upon disobedience of the statute when the statute does not require the act, the non doing of which is complained of by the plaintiff. Plaintiff's complaint, therefore, as to this cause of action stops at this point so far as it is predicated upon liability under the federal statute."

By the first count it was alleged the directors failed to register United and that while United was unregistered it held securities which depreciated $87,000,000.00. The Court held there was no duty on a registered company to

sell its securities, hence failure to register had no legal connection with the loss. Count two, also based on failure to register averred that an option exercised by directors which turned out to be a bad guess would not have happened if United was registered. The Court said:

> "Plaintiff's theory is that if United had refrained from voting and exchanging as required by Sec. 4 (a) (6), 4 (a) (3), and 4 (a) (4) of the Act, there would have been no loss since the consolidated preferred has maintained its market value and all accumulated dividends have been paid . . . Plaintiff does not allege, and we do not know, what would have happened with regard to this exchange of shares had United been registered and all the facts which a registration requires had been brought out. Even if the plaintiff had alleged that the exchange would never have taken place if United had been registered the complaint would still stop short of being legally sufficient unless it stated facts showing that the loss suffered happened in a way the statute was enacted to prevent. This he failed to do. We do not think, therefore, that what plaintiff complains of was occasioned either by owning or exchanging unless, as discussed above, the statute violator is to be held to complete insurer's liability."

District Judge Leahy in dismissing the *Downing* case below summarized his views as follows:

> "Clearly, then, the suit at bar is not a 'suit in equity * * * brought to enforce any liability or duty created' by the Act. Absent other jurisdictional elements, a minority stockholder may not resort to the federal courts on simple allegations that directors and officers, with other coconspirators, have violated federal statutes—such as anti-trust laws and the Interstate Commerce Act, 49 U.S.C.A. Sec. 1 et seq.—in addition to committing breaches of fiduciary duty." 68 F.Supp. at 10.

Birnbaum v. Newport Steel Corporation, 193 F.2d 461, (2d Cir., 1951) is also cited. There the Second Circuit had before it a suit brought on behalf of the Newport Steel Company by shareholders alleging jurisdiction under the Securities Exchange Act of 1934, 15 U.S.C.A. 78aa. Violation of fiduciary obligations by directors was pleaded in selling their stock in Newport and making fraudulent reports to Newport's stockholders. It was claimed S.E.C. Rule X-10B-5 was violated. The Court held that the claimed violations had no relation to breach of fiduciary duties by corporate insiders which resulted in fraud upon stockholders who were neither buyers nor sellers. (the protected class under the 1933 and 1934 Acts).

The Court rejected plaintiff's contention that the rule supplemented the common law liability of those who abuse the trust of their corporate positions and created a federal case and said:

> "But the appellants argue that such an interpretation of the Rule is too narrow to carry out the broad purpose of the Act to protect investors 'from exploitation by corporate insiders'. * * * We do not doubt that Congress was at least partially motivated by such a purpose in enacting the Securities Exchange Act of 1934, 15 U.S.C.A. Sec. 78a et seq. However, the precise question here is whether Section 10(b) of the Act and the Commission's Rule X-10B-5 were the means chosen to further that end, and we are of the opinion that the legislative 'history' and 'purpose' quoted by appellants are not persuasive that they were. When Congress intended to protect the stockholders of a corporation against a breach of fiduciary duty by corporate insiders, it left no doubt as to its meaning.[1]

[1] We observe that when Congress intended to create a federal case of director liability it made its meaning clear. The National Banking Act provides that directors of a National Bank who knowingly permit any of the officers, agents or servants of the association to violate any provisions of the Act, every director who

Thus Section 16 (b) of the Act of 1934, 15 U.S.C.A. Sec. 78p (b) a right of action against corporate insiders using their position to profit in the sale or exchange of corporate securities. The absence of a similar provision in Section 10 (b) strengthens the conclusion that that section was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10B-5 extended protection only to the defrauded purchaser or seller. Since the complaint failed to allege that any of the plaintiffs fell within either class, the judgment of the district court was correct and is accordingly affirmed."

The appellants then cite non-security cases illustrating lack of federal jurisdiction when none is legislatively conferred as follows:

Meyer et al. v. *Kansas City Southern Railway Company* (2 Cir. 1936), 84 F.2d 411, stockholders derivative action for conspiracy against railroads and directors alleged violation of antitrust laws;

Jacobson v. *New York, N. H. & H. R. Co.* (1 Cir. 1953), 206 F.2d 153, violation of Safety Appliance Acts;

Consolidated Freightways v. *United Truck Lines* (9 Cir. 1954), 216 F.2d 543, violation of Motor Carrier Act;

Miller v. *Long* (4 Cir. 1945), 152 F.2d 196, violation of National Housing Act;

Republic Pictures Corp. v. *Security First National Bank* (9 Cir. 1952), 197 F.2d 767, case involving mortgage on a copyright;

State Automobile Ins. Ass'n v. *Parry* (8 Cir. 1941), 123 F.2d 243;

participated in or assented to the same is to be held liable in his personal and individual capacity for all damages which the association, its shareholder or any other person shall have sustained in consequence of such violation 12 U. S. C. A., Section 93.

Note: 14 A.L.R. 2d 992—What actions arise under the laws and treaties of the United States so as to vest jurisdiction of Federal Courts.

3.

As to the lack of congressional intent to create a body of federal law respecting liability of directors of investment companies. Such review as we have been able to make of the legislative history has afforded little assistance either in justifying or refuting the implication of a private right of suit such as claimed here. Senate and House Committees reports are devoid of clear reference to civil liability except with respect to provisions expressly imposing it. We are cited to the analysis of the Investment Company Act of 1940 in 50 Yale L. J. 441, 446, that "the original draft of the section" (now 15 U.S.C.A. 80a-9) "which required all investment company officers and directors to register as individuals with the S.E.C. and become subject to such disqualification as that body should propose drew a storm of protest from the industry." As passed, the director registration requirement was deleted. The original bill had further provided that if any person registered under the Act was guilty of gross misconduct or gross abuse of trust he would be guilty of a crime. This provision was omitted from the Act. The note in the journal continued by saying, that; "It was suggested during the hearings on the original bill that this whole problem" (managerial responsibility) "could be solved most expeditiously by declaring investment company managements to be trustees in fact with trustee obligations to their stockholders.". This proposal, however, which would have involved drastic managerial responsibility, was rejected except to the extent that "gross abuse of trust" was made a ground for restraining the guilty party from further connection with the industry. The "gross abuse" section referred to is 15 U.S.C.A. 80a-35 and the

Securities and Exchange Commission is the one there authorized to bring the action.

Congress did refrain from including in the Acts any control or regulation or expansion of the common law duties of directors of investment companies and the failure to provide any private civil remedies or for joint and several liability or contribution or statutes of limitation such as are found in the 1933 and 1934 Acts indicates that the omission was deliberate. At common law directors are liable to exercise due care and to render them liable by implication on account of violations of the Acts by others would be a drastic innovation.

Senator Lodge of Massachusetts stated in the Senate on June 21, 1940, in urging the passage of the present Act:

> "It so happens that the investment trust business is one which very largely had its origin in Boston and I happen to know a great many people connected with this industry. * * *
>
> This bill, as the Senator from New York has said, was agreed upon after very painstaking and careful study, in which really almost a miracle occurred, in that all the various elements in the industry were able to get together and organize themselves, and present a common basis for studying the question, and as the result of that effort an agreement which is embodied in this bill was reached between those engaged in the industry and the members of the S.E.C. I submit that that is a very unusual and very beneficial occurrence——."

It seems improbable that there would have been such unanimity for the passage of the Act if it had been thought to impose any such per se liability on directors as is claimed by plaintiffs here. The failure to provide for any private civil remedies or for joint and several liability of directors and persons who commit or contrib-

ute to violations or for statutes of limitations or for conditions is persuasive that the omission was deliberate. Certainly, the Courts will imply a liability only to implement a manifest legislative intent. The enactments as they stand do not justify implications that jurisdiction was intended to be conferred.

The appellees in support of the jurisdiction and the ruling appealed from contend that the facts alleged in the complaints state a claim upon which the Investment Company Act of 1940 provides a remedy to Managed Funds and against appellants in the Federal District Court. They have cited and relied on the following provisions of the Act and texts and decisions:

Alfred Inv. Trust et al. v. *Securities and Exchange Commission*, 151 F.2d 254 (1st Cir., 1945)
Alleghany Corporation v. *Breswick & Co.*, 353 U.S. 151 (1957)
Baird v. *Franklin*, 141 F.2d 238 (2d Cir., 1944)
Bell v. *Hood*, 327 U.S. 678 (1945)
Birnbaum v. *Newport Steel*, 193 F.2d 461 (2d Cir., 1951)
Brandt v. *Renfield*, 278 F.2d 904 (8th Cir., 1960)
Breswick & Co. v. *United States*, 134 F.Supp. 133 (S.D.N.Y. 1955), 138 F.Supp. 123 (1956)
Breswick & Co. v. *Briggs*, 135 F.Supp. 397 (1955)
Cogan v. *Johnson*, 162 F.Supp. 907 (S.D.N.Y., 1958)
Collings v. *Busch Manufacturing Co.*, 19 F.R.D. 297, (S.D.N.Y., 1956)
Downing v. *Howard*, 68 F.Supp. 6 (D. Del. 1946) 162 F.2d 654 (3d Cir., 1947)
Errion v. *Connell*, 236 F.2d 477 (9th Cir., 1956)
Fielding v. *Allen*, 181 F.2d 163 (2d Cir., 1950)
Fischman v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951)
Fratt v. *Robinson*, 203 F.2d 627 (9th Cir., 1953)
Goldstein v. *Groesbeck*, 142 F. 2d 422 (2d Cir., 1944)

Gully v. *First National Bank in Meridian*, 299 U.S. 109 (1936)

Hawkins v. *Merrill Lynch, Pierce, Fenner & Beane*, 185 F.Supp. 104 (W.D.Ark., 1949)

Hooper v. *Mountain States Securities Corporation*, Par. 90,972, C.C.H. Federal Securities Law Reporter.

Howard v. *Furst*, 238 F.2d 790 (2d Cir., 1956)

Hurn v. *Oursler*, 289 U.S. 238 (1933)

R. H. Johnson & Co. v. *S.E.C.*, 198 F.2d 690 (2d Cir., 1952)

Jung v. *K & D Mining Co.*, 260 F.2d 607 (7th Cir., 1958)

Kardon v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D.Pa. 1946), 73 F.Supp. 798 (1947)

In re Managed Funds, Incorporated, Par. 76,662, C.C.H. Federal Securities Law Reporter, Current.

Schwartz v. *Bowman*, 156 F.Supp. 361 (S.D.N.Y. 1957)

Schwartz v. *Eaton*, 264 F.2d 195 (2d Cir., 1959)

Slavin v. *Germantown Fire Ins. Co.*, 174 F.2d 799 (3rd Cir., 1949)

Sparks v. *England*, 113 F.2d 579 (8th Cir., 1940)

Stadia Oil & Uranium Co. v. *Wheelis*, 251 F.2d 269 (10th Cir., 1957)

Stella v. *Kaiser*, 82 F.Supp. 301 (S.D.N.Y., 1948)

Taussig v. *Wellington Fund, Inc.*, Par. 90,979, C.C.H. Federal Securities Law Reporter, Current 187 F.Supp. 179, (D.Del., 1960)

Statutes Cited:

79j (Rule X-10B-5), 78aa, 78p of Title 15, U.S.C.A., 79y, 79z of Title 15, U.S.C.A.

80a-1 (b) of Title 15, U.S.C.A.

80a 2 (a) (19) of Title 15, U.S.C.A.

80a-8 (b) of Title 15, U.S.C.A.

80a-10 of Title 15, U.S.C.A.

80a-13 (a) (3) of Title 15, U.S.C.A.

80a-15 of Title 15, U.S.C.A.

80a-16 of Title 15, U.S.C.A.
80a-33 of Title 15, U.S.C.A.
80a-43 of Title 15, U.S.C.A.
80a-46 (b) of Title 15, U.S.C.A.
80a-47 of Title 15, U.S.C.A.
Rules Cited:
Rule 8a Federal Rules of Civil Procedure.
Texts Cited:
Congressional Record, 1940, P. 10074
Green, George Washington Law Review, Vol. 28
Jaretski, 26 W.U.L.Q. 303
61 Harvard Law Review 858
Report of Hearing of H.B. 100065, Subcommittee of Committee of Interstate and Foreign Commerce (76th Congress, 3rd Session)
Restatement of the Law of Torts, Section 286
Senate Report No. 1775, 76th Congress, 3rd Session June 6, 1940.

In the first place, the appellees stress the decision in the *Kardon*-case, supra, and the fact that the Court there found federal jurisdiction by implication both because the defendant had violated a legislative enactment causing damage to plaintiff and because the statute declared that the contract so obtained in violation "shall be void". We do not express disagreement in any respect with the *Kardon* decision and others in accord with it. In *Kardon* the party damaged by a contract obtained in violation of a federal law, which contract the law made void, was allowed to sue in federal court the party who offended and profited. But we do not hold the situation here to be analogous.

Goldstein v. *Groesbeck*, 142 F.2d 422, (2d Cir., 1944) involved a void contract under the Holding Company Act. Defendant, Electric Bond & Share, was the top holding company and through American Power & Light it controlled four power companies. It had construction con-

tracts with the power companies and caused the contracts to be taken over by corporations organized by it. By the Act it was unlawful for an unregistered holding company to enter into construction or service contracts with public utilities. Goldstein brought the action as a shareholder of American derivatively for American and the controlled power companies to compel an accounting for profits gained by the construction and service corporations and certain of their officers and directors. The court decided that but for the Act the payment under the contracts would have been lawful, therefore, "the words 'any liability or duty' are clearly broad enough to include any breaches of duty causing injury or loss to private persons." The void contract theory is enunciated as follows:

> "As we have seen, the Act makes it unlawful for unregistered holding companies to enter 'directly or indirectly' into service or construction contracts . . .
>
> Violation being thus established, Sec. 26 (b), 15 U.S.C.A. Sec. 79z (b), in express terms declared the contracts void. It should follow that the operating companies are entitled to a refund, for no other result can fulfill the expressed purpose of the Act of protecting subsidiaries from the overreachings of holding companies. Thus, the statutory declaration of the necessity for control of holding companies in Sec. 1 (b) (2), 15 U.S.C.A. Sec. 79a (b) (2), states, inter alia, that the national public interest is adversely affected 'when subsidiary public utility companies are subjected to excessive charges for services'. The three specific sanctions stated in the Act—— injunction, Sec. 18 (f), 15 U.S.C.A. Sec. 79r (f); criminal punishment, Sec. 29, 15 U.S.C.A. Sec. 79z-3; and the negative relief of Sec. 26 (b), declaring the contracts void——do not in terms place the defrauded operating company in status quo; and Sec. 26 is incomplete, if not ineffective, unless it is considered to authorize recovery by the operating companies . . .

> . . . Furthermore, the analogy of the Securities Exchange Act is again useful. Private enforcement of Sec. 29 (b) of that statute has been permitted, *Geismar* v. *Bond & Goodwin, Inc.*, supra, while we have recently upheld broadly the private rights of action impliedly granted by the Securities Exchange Act, *Baird* v. *Franklin*, 2 Cir., 141 F.2d 238; and cf. *Charles Hughes & Co.* v. *S. E. C.*, 2 Cir., 139 F.2d 434, certiorari denied 64 S.Ct. 781. As we have pointed out in those cases, we think a denial of a private right of action to those for whose ultimate protection the legislation is intended leaves legislation highly publicized as in the public interest in fact sadly wanting, and even delusive, to that end."

The case did not involve asserted liability of the directors of Electric Bond & Share to it for causing it, through its controlled construction and service corporation, to enter into the void contracts with the power companies. Goldstein sought an accounting for "profits" made by the directors and the construction and service companies illegally contracting with the operating companies. Electric Bond & Share was a party because it acted through its controlled construction and service corporation. In other words, this was a suit for recovery of the consideration paid by the operating companies under the void contract. The Court carefully reserves the question of whether the recovery would be for the entire consideration or the excess thereof over the reasonable value of the services rendered. The case illustrates that jurisdiction implied under the void contract theory requires privity and does not hold that directors may be held liable to account to the corporation for return of a consideration which they did not receive.

Referring to *Geismar* v. *Bond & Goodwin, Inc.* supra, the Court there said:

> "A useful analogy in favor of this interpretation of implied liability can be found in Sec. 29 of the

Securities Exchange Act which is virtually identical with Sec. 26 of the Utility Act for it is now clear from the 1938 amendment to Sec. 29, 52 Stat. 1076 that Congress intended a right of recovery thereunder."

The section referred to is 15 U.S.C.A. 78cc (b) and the 1938 amendment is a provision added to the void contract section of the Exchange Act of 1934 reading:

> "Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of Section 78o of this title, and (b) that no contract, shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection by any person to or for whom any broker or dealer sells, or buying from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 78o of this title, unless such violation is brought within the year after discovery and within three years after such violation."

Appellees argue that as the corporation acts through its officers and directors such parties in control must be held liable because if the company violates the acts they directly or indirectly cause the violation. They contend that the directors should be held liable under Section 80a-47 which provides:

> "(a) It shall be unlawful for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do under the provisions of this subchapter and section 72 (a) and 107 (f) of Title 11 or any rule, regulation, or other thereunder.

"(b) It shall be unlawful for any person without just cause to hinder, delay, or obstruct the making, filing, or keeping of any information, document, report, record, or account required to be made, filed, or kept under any provision of this subchapter and section 72 (a) and 107 (f) of Title 11 or any rule, regulation, or order thereunder. Aug. 22, 1940, c. 686, Title 1, section 48, 54 Stat. 846."

Section 80a-33 (b) provides:

"(a) It shall be unlawful for any person, except as permitted by rule, regulation, or order of the Commission, willfully to destroy, mutilate, or alter any account, book or other document the preservation of which has been required pursuant to section 80a-30 (a) or 80a-31 (c) of this title.

"(b) It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this subchapter and sections 72 (a) and 107 (f) of Title 11 or the keeping of which is required pursuant to section 80a-30 (a) of this title. It shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading. For the purposes of this subsection, any part of any such document which is signed or certified by an accountant or auditor in his capacity as such shall be deemed to be made, filed, transmitted, or kept by such accountant or auditor, as well as by the person filing, transmitting, or keeping the complete document. Aug. 22, 1940, c. 686, Title 1, section 34, 54 Stat. 840."

Stadia Oil & Uranium Co. v. *Wheelis*, 251 F.2d 269 (10th Cir., 1957) is cited in support. There purchasers of se-

curities which were sold in violation of the 1933 Act sued one Rankin, a Vice-President and director of the corporation, among others and he denied participation. It was a jury question whether he was in "control" within the meaning of section 77a of the Act and under proper instructions the jury's verdict that he was in such control was sustained.

In *Hawkins* v. *Merrill Lynch et al.* 85 F.Supp. 104 (W.D.Ark. 1949) also cited to the same point. It was held that where the defendant was sued and held liable for sales of securities in violation of the Exchange Act of 1934 directed another in such a manner as to violate the rights secured by the legislation "there exists that degree of control necessary to create liability under section 78t (a)."

R. H. Johnson & Co. v. *Securities & Exchange Commission*, 198 F.2d 690 (2d Cir., 1952) also cited to the point. But we do not find that either of these three cases lend substantial support to appellees.

The Holding Company Act provision 79z-1 is the same as the Investment Act 80a-47. The Securities Act of 1933 has no comparable section. The Exchange Act of 1934 does have a comparable section 78t (b). Both the 1933 and 1934 Acts have sections making a person controlling any person who is liable under these Acts, jointly and severally liable with the controlled person (77o and 78t). The Investment Company Act has no such provision nor does the Holding Company Act. With respect to controlling persons the Investment Company Act indicates by its definition of "control" that the powers of control which inure to directors solely as the result of their official position in the company are not included in the word "control" used in respect to provisions in the Act. The definition reads:

> "'Control' means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company."

Appellants insist and we agree that this wording of the Act shows that it was the legislative intent to refrain from entering the field of director responsibility. There is a sense in which it can be said as appellees have argued that directors control the various corporate actions of management on policy, but by this provision directors acting in their official capacity are excluded from being held liable on that theory. As was stated in *Downing* v. *Howard*, 68 F.Supp. 6, 10, "At best, the alleged violations were violations by United. There is no provision in the Act imposing a duty or liability on officers or directors as such or upon outsiders acting in concert with officers and directors."

Appellees cite *Hooper* v. *Mountain States Securities Corporation*, ... F.2d ... (5th Cir., 1960) which was brought under the 1934 Act to recover on account of a fraudulent scheme concerted by defendants to have shares of stock issued for worthless property in order that the individuals could divide up the stock for their own use and get the benefits of their fraud. The court held the transactions to be within the purchase and sale provisions of the 1934 Act and the regulation. But on its facts the case does not have a bearing on the problem here in issue.

In *Taussig* v. *Wellington Fund, Inc.*, 187 F.Supp. 179 (D.C.Del. 1960) the controversy was between two investment companies both employing the name Wellington, which name was also used by the underwriters and advisors. The Court held the first investment company had the right to use the name Wellington and that use by the other was enjoined. Several provisions of the securities Acts were relied on to confer jurisdiction including

80a-34 (d) which makes it unlawful "for any unregistered investment company to adopt as a part of the name or title of such company any word or words which the Commission finds and by order declares to be deceptive or misleading". It appeared to the Court that as the federal claim was not frivolous or a sham the Fund had standing to prosecute the action but there was no need to rule substantively on the federal causes.

In *Aldred Mo. Trust* v. *Securities and Exchange Commission*, 151 F.2d 254 (1st Cir., 1945) the Commission sued under the Investment Company Act to enjoin the officers of an investment trust from continuing to act in such capacity and for the appointment of a receiver under 15 U.S.C.A. 80n-35 commonly referred to as the "gross abuse of trust" section. The case illustrates the instance in which the Act does deal with the matter of directors duty. It creates a right of action against directors to remove them from office for gross abuse of trust but it must be done on the initiative of the Commission. It furnishes no support for the liability of directors which Fund asserts on this appeal. In paragraph 1 and 2 on page 260, the Court refers to provisions of 15 U.S.C.A. Sec. 80a-1 (b) as effecting a codification of the fiduciary obligations imposed upon officers and directors of investment companies but the codification is of duties of the companies and the reference does not support a conclusion that Congress thereby created a federal cause of action in private individuals or by investment companies against their directors.

In *Cogan* v. *Johnson*, 162 F.Supp. 907 (S.D.N.Y. 1958) the plaintiff sueing individually and as a stockholder of an investment company which had been deregistered by the Securities and Exchange Commission charged a continuing conspiracy by the company and its officers and directors to violate the 1940 Investment Company Act and with

violations of the Act "in numerous ways". The relief sought was injunction against the continuing violations of the Act and injunction against the individual defendants preventing them from combining as officers and directors and for the appointment of a receiver to enable the company to comply with the Act. There was also a charge that the defendants caused the company to violate the Act for their own interests and were guilty of gross abuse of trust as officers and directors.

The District Court held that the individual stockholders had no standing to bring an action based on the gross abuse of trust section, 15 U.S.C.A. 80a-35. The Court declared however that it did not "appear to a certainty that the plaintiff is entitled to no relief under any state of facts which may be proved in support of his claim" and denied the motion to dismiss.

The appellants say in reference to the *Cogan* case that if the holding there is that directors are liable for the acts of their corporation in violation of the 1940 Act, it is wrongly decided and should not be followed by this Court.

Respecting *Schwartz* v. *Bowman*, 156 F.Supp. 361 (S.D.N.Y., 1957) and related cases of *Breswick & Co.* v. *United States*, 134 F.Supp. 133 (S.D.N.Y., 1955), and *Breswick & Co.* v. *Briggs*, 135 F.Supp. 397 (1955) the federal case in *Schwartz* was violation by the Alleghany Railroad of the Investment Company Act by acquiring the New York Central stock without registering under the Act. The Court on appeal said a joint venture or conspiracy to cause C. & O. and Alleghany to engage in a transaction prohibited by the Act was charged. Appellants stress the contention that "there is a fundamental and critical distinction to be drawn between a case where a director is an actor and joint tort feasor in violating a statute and a case where the asserted liability is predicated upon vicarious

liability for allegedly causing the corporation he serves to violate the statute". Because the Investment Company Act does not as do the 1933 and 1934 Acts create a joint duty and liability none can be implied to create a federal case. The conspiracy in the *Schwartz* and *Brunswick* cases distinguish them from the present appeal.

We do not find *Bell* v. *Hood*, 327 U.S. 678 (1945) to be relevant. The intent and effect of the decision as applied to the facts in that case were thoroughly considered by the District Court when the case was returned to it. 71 F.Supp. 813. The claim before the Supreme Court was that defendants had violated specified provisions of the federal law and Constitution. The doctrine of jurisdiction by implication where the federal statute has not imposed a duty was not discussed by the Supreme Court.

The District Court stated the rule it was required to follow, l. c. 820:

> "'Where, as here, neither the Constitutional provision nor any Act of Congress affords a remedy to any person, the mere assertion by a plaintiff that he is entitled to such a remedy' does not constitute a federal cause of action. . . .
>
> "In assuming jurisdiction under mandate of the Supreme Court, this Court is called upon to decide 'the issue of law . . . whether federal courts can grant money recovery for damages said to have been suffered as a result of federal officers violating the Fourth and Fifth Amendments.' . . .
>
> "Being of the opinion that neither the Constitution nor the statutes of the United States give rise to any cause of action in favor of the plaintiffs upon the facts alleged, I hold that federal courts cannot now grant such recovery. Nor does any other ground appear upon which relief can be granted to plaintiffs in this Court."

On consideration of the whole record and citations we conclude the claim stated against these appellants does not support the federal jurisdiction. At common law directors are liable to exercise due care and are not insurers. 13 Am. Jur. Corporation Sec. 990, p. 943-944. The complaints here substantially seek to hold these former directors to strict liability as insurers. The Act they rely on not only contains no such provision but plainly negates any intent to create such an innovation. The reliance upon implication to support the jurisdiction is not justified in the face of the legislative intent to exclude it.

In view of the conclusion that the motions for dismissal as to these appellants for lack of jurisdiction of the subject matter of the claim against them should be sustained, we need not discuss the question as to the out of the State service upon appellants, Rebstock and Rice.

Reversed with direction to dismiss the case as to these appellants.

A true copy.

Attest:

Robert C. Tucker,
Clerk, U. S. Court of Appeals, Eighth Circuit.

(Seal)

APPENDIX B.

(Judgment.)

United States Court of Appeals for the
Eighth Circuit.

No. 16,566—September Term, 1960.

J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, Jacob Baker and George H. Shields, III,
Appellants,

vs.

Managed Funds, Incorporated, a Corporation, Emanuel Josephson and Protective Casualty Insurance Company.

Appeal from the United States District Court for the Eastern District of Missouri.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Missouri and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the Order of the said District Court overruling Motions to dismiss entered July 1, 1960, be, and the same is hereby, reversed with costs; and that J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice have and recover against Managed Funds, Incorporated, a Corporation, Emanuel Josephson and Protective Casualty Insurance Company the sum of Two Hundred Forty and 65/100 ($240.65) Dollars for their costs in this behalf expended and have execution therefor.

And it is further Ordered by this Court that this cause be, and it is hereby, remanded to said District Court with direction to dismiss the case as to appellants, J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock, Earl R. Rice, Jacob Baker and George H. Shields, III.

January 13, 1961.

APPENDIX C.

(Statute and Rule Involved.)

Sections 1 (b) (1), (2), (4), and (6), Sections 80a-1 (b) (1), (2), (4) and (6) of Title 15, U. S. C.:

"(b) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 79z-4 of this title, and facts otherwise disclosed and ascertained, it is declared that the national public interest and the interest of investors are adversely affected—

"(1) when investors purchase, pay for, exchange, receive dividends upon, vote, refrain from voting, sell, or surrender securities issued by investment companies without adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management;

"(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders;

"(4) when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably distributed, or when investment companies are managed by irresponsible persons;

"(6) when investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders;

. . . .

"It is declared that the policy and purposes of this subchapter and sections 72 (a) and 107 (f) of Title 11, in accordance with which the provisions of this subchapter and sections 72 (a), and 107 (f) of Title 11 shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors. Aug. 22, 1940, c. 686, Title I, § 1, 54 Stat. 789."

Section 9 (a), Section 80a-9 (a) of Title 15, U. S. C.:

"(a) It shall be unlawful for any of the following persons to serve or act in the capacity of officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust or registered face-amount certificate company:"
(here follows a list of persons disqualified from serving.)

Section 10 (a), Section 80a-10 (a) of Title 15, U. S. C.:

"(a) After one year from the effective date of this subchapter and sections 72 (a) and 107 (f) of Title 11, no registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are investment advisers of, affiliated persons of an investment adviser of, or officers or employees of, such registered company."

Sections 15 (a) and (c), Sections 80a-15 (a) and (c) of Title 15, U. S. C.:

"(a) After one year from the effective date of this subchapter and sections 72 (a) and 107 (f) of Title 11 it shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, unless in effect prior to March 15, 1940, has been approved by the vote of a majority of the outstanding voting securities of such registered company and—

"(1) precisely describes all compensation to be paid thereunder;

"(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

"(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

"(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser."

. . . . . .

"(c) In addition to the requirements of subsections (a) and (b) of this section it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any con-

tract or agreement, written or oral, except a written agreement which was in effect prior to March 15, 1940, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party, or (2) by the vote of a majority of the outstanding voting securities of such company."

Section 8 (b) (2), Section 80a-8 (b) (2), of Title 15, U. S. C.:

"(b) Every registered investment company shall file with the Commission, within such reasonable time after registration as the Commission shall fix by rules and regulations, an original and such copies of a registration statement, in such form and containing such of the following information and documents as the Commission shall by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors:

. . . .

"(2) a recital of the policy of the registrant in respect of matters, not enumerated in paragraph (1) of this subsection, which the registrant deems matters of fundamental policy and elects to treat as such:"

Section 13 (a) (3), Section 80a-13 (a) (3) of Title 15, U. S. C.:

"(a) No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities—

. . . . . .

"(3) deviate from its policy in respect of concentration of investments in any particular industry or group of industries as recited in its registration statement, or deviate from any fundamental policy recited in its registration statement pursuant to section 80a-8 (b) (2) of this title;"

Section 44, Section 80a-43 of Title 15, U. S. C.:

"The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter and sections 72 (a) and 107 (f) of Title 11, or the rules, regulations, or orders thereunder and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and sections 72 (a) and 107 (f) of Title 11 or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 80a-33 of this title, or upon a failure to file a report or other document required to be filed under this subchapter and sections 72 (a) and 107 (f) of Title 11, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and sections 72 (a) and 107 (f) of Title 11 or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or

wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28 and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter and sections 72 (a) and 107 (f) of Title 11 brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title I, § 44, 54 Stat. 844."

Section 47 (b), Section 80a-46 (b) of Title 15, U. S. C.:

"(b) Every contract made in violation of any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or of any rule, regulation, or order thereunder, and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, regulation, or order. Aug. 22, 1940, c. 686, Title I, § 47, 54 Stat. 845."

Rule 8 (a) of the Federal Rules of Civil Procedure:

"(a) **Claims for Relief.** A pleading which sets forth a claim for relief, whether an original claim, counter-

claim, cross-claim, or third-party claim, shall contain (1) a short and plain statement of the grounds upon which the court's jurisdiction depends, unless the court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief to which he deems himself entitled. Relief in the alternative or of several different types may be demanded."

Office Supreme Court, U.S.
FILED
JAMES R. BROWNING, Clerk

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM 19[illegible]

No. ~~847~~ 87

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

BRIEF

For Respondents, J. John Brouk, Jefferson J. Rebstock, Earl R. Rice, W. Munro Roberts, Jr. and James J. Mullen, Jr., in Opposition

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1960.

No. 947.

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

BRIEF

For Respondents, J. John Brouk, Jefferson J. Rebstock, Earl R. Rice, W. Munro Roberts, Jr., and James J. Mullen, Jr., in Opposition.

INTRODUCTION.

Respondents, J. John Brouk, Jefferson J. Rebstock, Earl R. Rice, W. Munro Roberts, Jr. and James J. Mullen, Jr., constitute all of respondents except Jacob Baker and George H. Shields, III, and wherever the word "respondents" is used in this brief it will embrace the five aforenamed. Petitioner will be referred to as "Fund."

OPINIONS BELOW.

The District Court overruled motions of respondents to dismiss the complaint for lack of jurisdiction of the subject matter and also lack of jurisdiction of the person re-

specting respondents, Earl R. Rice and Jefferson J. Rebstock. The District Court filed no opinion. The opinion of the Court of Appeals reversing the order of the District Court is reported at 286 F. 2d 901, and printed as "Exhibit A" to petitioner's petition at page 29.

JURISDICTION.

The jurisdiction of this Court rests on 28 U. S. C. 1254 (1).

QUESTIONS PRESENTED.

Section 44 of the Investment Company Act of 1940 entitled "Jurisdiction of Offenses and Suits" creates concurrent jurisdiction in District Courts of the United States and State Courts of "all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of" the Act.

The question presented is whether the Act creates any federal statutory duties respecting directors of registered investment companies, the violation of which gives rise to a cause of action by an investment company against its directors within the jurisdiction of the District Courts of the United States.

STATUTE INVOLVED.

The statute involved is the Investment Company Act of 1940. The portions relied on by petitioner are set out as Appendix C to petitioner's petition at page 67. Additional sections of such Act, as well as sections of the Securities Exchange Act of 1934, referred to in this brief, are printed as Appendix 1 hereto.

STATEMENT.

The type of case involved on the petition for certiorari here before this court is a civil action in tort for damages brought by petitioner, Managed Funds, Incorporated, a mutual fund and registered investment company, against its investment adviser, the companies which sold its shares, its officers and directors, its New York broker and some of the broker's employees.

The asserted bases of liability essentially are:

1. The investment adviser delegated its advisory function to the broker, but nevertheless was paid for services it did not render.

2. The broker rendered the advisory service in exchange for brokerage business arising from Fund's portfolio transactions.

3. The adviser and the broker handled Fund's portfolio so that there was a deviation from Fund's stated policy of capital growth.

4. That the foregoing acts were in violation of the Investment Company Act of 1940 and the adviser, the broker, the sales companies, the officers and directors of Fund are jointly and severally liable under federal law and the case is within the jurisdiction of the Federal Courts.

There is presented here only the question of federal jurisdiction respecting seven directors.

By the judgment of the United States Court of Appeals for the Eighth Circuit in Brouk et al. v. Managed Funds, Incorporated, et al. (286 F. 2d 901, printed as Appendix (B) to Fund's petition, page 65), the District Court was ordered to dismiss the case as to seven former directors of Fund who attacked the Fund's amended complaint (and the Josephson complaint) by motions to dismiss for lack

of federal jurisdiction of the subject matter and with respect to respondents, Jefferson J. Rebstock and Earl R. Rice, also, lack of jurisdiction of the person (R. 21-28).

On May 12, 1959, Emanuel Josephson brought a stockholder's derivative action for the benefit of Managed Funds, Incorporated, in the District Court of Delaware. This action was subsequently transferred to the District Court at St. Louis (R. 12). This complaint was adopted by intervenor, Protective Casualty Insurance Company (R. 39). On October 23, 1959 Fund filed its amended complaint in the District Court (R. 1). Only Fund appeared on the appeal heard by the Court of Appeals (286 F. 2d 901). **Fund is the only petitioner here.**

The judgment of the Eighth Circuit is, therefore, final respecting the complaint of Emanuel Josephson and the adoption thereof by intervenor, Protective Casualty Insurance Company. It follows that this court's consideration of the petition for certiorari should be limited to consideration of the amended complaint of Fund.

The identity of the parties defendant in relationship to Fund is as follows:

These respondents are five of a group of twelve former directors who are collectively described in petitioner's amended complaint as "outside directors" (R. 3).

Defendants, Hilton Slayton and Hovey Slayton, are former officers and directors of Fund. Defendant, Slayton Associates, Inc., was the investment adviser of Fund under a contract of August 15, 1952 approved by Fund's shareholders and successively renewed by the directors until April 19, 1959. Defendants, Slayton & Company, Inc. and Mutual Fund Distributors, Inc., were underwriters engaged in selling Managed Fund shares to the public. Defendant, Model, Roland & Stone, is a partnership of eleven individuals and are New York brokers (R. 3). Defendants, James S. Stubbs and Harold W. Smith, are employees

of the broker partnership. Defendant, Stephen M. Jaquith, was an associate of the defendant broker partnership. None of these defendants challenged the jurisdiction of the District Court. The case is still pending in the District Court respecting the asserted liability of such defendants. The amended complaint admits the "outside directors" were not conspirators, and did not profit from the alleged wrongful acts, nor receive any so-called wrongful payments (R. 10, 11).

The averment respecting the outside directors is as follows: "On information and belief, the said outside directors, and each of them, had either actual knowledge of the acts hereinafter complained of, or, in the performance of the duties and obligations imposed upon them by law as directors, and by the exercise of ordinary care and diligence in the performance of such duties and obligations, would have acquired knowledge of such acts, and hence are chargeable with having constructive knowledge thereof" (R. 3).

The "acts" referred to are that the adviser, Slayton Associates, Inc., on December 1, 1953, contracted with defendant Jaquith to act as investment counsellor and manager of the securities portfolio of Fund, after which time the adviser received fees for advisory services not performed by reason of the adviser having unlawfully delegated its duties to Jaquith and "abdicated its duties and responsibilities under its advisory contract with Fund (R. 4, 5). The 1953 contract provided Jaquith was to receive $50,000.00 per annum for five years and $35,000.00 for the succeeding five years as minimum payments to apply against brokerage commissions respecting business which the adviser, Slayton Associates, would direct to Jaquith or his designees. The broker defendants, Model, Roland & Stone, it is averred, became the designee and brokerage business was directed to them whereby they received brokerage commissions in excess of $1,500,000.00 (R. 5). The

brokers are averred to have paid to defendants, Smith & Stubbs, annual brokerage commissions in excess of $50,000.00 a year. It is then averred that after Jaquith and Model, Roland & Stone furnished advisory service the Fund's basic policy of capital growth was not followed and gross mismanagement resulted. Loss and damage to the investment portfolio of Fund ensued, as well as greatly increased brokerage commissions and greater payments under the sales contracts without any benefit to the Fund (R. 6). Following the foregoing specific facts setting out the alleged wrongful conduct of the investment adviser and broker defendants, the amended complaint states:

> "Plaintiff further states, on information and belief, that the defendants committed, or with actual or constructive knowledge, as hereinabove set forth, aided, abetted, acquiesced in or condoned, directly or indirectly, violations of the Investment Company Act of 1940, in that, inter alia,
>
> (a) The plaintiff was operated, managed, and its portfolio securities were selected, in the interest of directors, investment advisers, and other affiliated persons thereof, and in the interest of underwriters, brokers and dealers, rather than in the interest of all classes of plaintiff's security holders; (R. 6)
>
> (b) The plaintiff was caused to publish, circulate and file with the Securities and Exchange Commission required registration statements, amendments thereto, reports and prospectuses, which documents contained untrue statements of material facts or omitted to state material facts required to be stated therein or necessary to make the statements therein not misleading; (R. 7)
>
> (c) The plaintiff was caused to deviate from a fundamental policy recited in its registration statement pursuant to Section 8 (b) (2) of the Act, without being authorized to do so by the vote of a majority of its outstanding voting securities; and

(d) Defendants, Leo Model, Rolf R. Roland, Frits Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Frank L. Thompson and Herman H. Stone, as members of a co-partnership doing business under the name of Model, Roland & Stone, and Stephen M. Jaquith, individually, served or acted as investment advisers of the plaintiff, without a written contract approved by the vote of a majority of the outstanding voting securities of plaintiff." (R. 7).

Respecting Counts II, III and IV of the amended complaint Fund states: "Count II asserts liability for losses under the Securities Act of 1933; Count III bases liability for breaches of fiduciary duties, and Count IV seeks recovery on the claim of conspiracy. Such counts may be joined with petitioner's statutory claim, Hurn v. Oursler, 289 U. S. 238 (1933)." (P. Brief 5). Thus, it is conceded these are common law counts cognizable in a Federal Court only if pendente to a federal case if one is stated by Count I.

The amended complaint presents no question respecting the regulatory provisions of the Investment Company Act and the administration of the law by the Securities and Exchange Commission. There is no averment pointing to any specific provision of the Act whereby a federally created private civil action for damages is authorized or created in favor of an investment company against its directors. The case pleaded is no more and no less than a damage suit in tort attempted to be based upon violation of a federal statute by the Fund, itself a tort-feasor, against its officers and others who were actors with asserted joint liability against directors. The averment that the directors "committed" the violations by others, or condoned the same, or negligently failed to discover and prevent, raises the question whether the Act creates federal rights in favor of mutual funds against their own directors so that federal jurisdiction may be implied respecting private actions for damages.

OUTLINE OF ARGUMENT.

I.

The Investment Company Act of 1940 is not a Federal Corporation Code, superimposed on state law, regulating the internal affairs of every corporation engaged in the mutual fund business and it does not expressly or by implication impose federal standards of responsibility or new federal duties on directors. It does not point to a congressional intent that a body of federal law be fashioned by judicial decision to govern director duties and liabilities.

II.

Asserted conflict between decisions of United States Courts of Appeal must in fact exist to constitute a valid basis for the granting of a writ of certiorari. The question of director duty and liability was not raised or decided in Goldstein v. Groesbeck. The claimed conflict is illusory.

ARGUMENT.

I.

The Fund's Amended Complaint Does Not Support Federal Jurisdiction and the Decision of the Court of Appeals So Holding Is Clearly Correct.

It is appropriate at the outset of this argument to have in mind the Fund disclaims that it is asserting respondent directors are liable as insurers to Fund by virtue of their official character as its directors (P. Pet. 22). Fund's precise contention is summarized at page 26 of its petition as follows:

> "The issue here is neither non-feasance nor mere negligence. The issue here is liability of directors for irresponsible violation of law in the management of other people's money. Even when they do not directly profit by the unlawful operation, they have lent their names to the enterprise and must be held to have accepted the responsibility and duties specifically imposed by the statute. As joint tort-feasors, they must be held to respond in damages if they violate the very provisions of the law which they are appointed to enforce, wherever such violation of duty causes losses to the investors."

To say that non-feasance and negligence are not involved, and that the basis of liability is "irresponsible violation of law" is a complete non sequitur. That directors are "appointed to enforce" the Investment Company Act and are joint tort-feasors with the corporation they serve is in fact an assertion of insurers liability. There are no federally created responsibilities and duties of directors set out anywhere in the Act upon which to predicate federal jurisdiction.

Respondents are in agreement with petitioner that the Investment Company Act of 1940 regulates registered investment companies. We are in complete disagreement that it regulates directors. The Act prohibits more than 60% of the directors to be affiliated with an investment adviser and it follows that 40% of the directors must be unaffiliated. It requires advisory contracts to be approved by shareholders and renewals of advisory contracts require the vote of a majority of the unaffiliated directors, failing which such contracts are void. Advisory contracts are not assignable. An investment company must state its fundamental investment policy and deviation therefrom is prohibited. Such are the provisions of the Act, printed as Appendix C, page 67 of petitioner's petition.

It is true as petitioner argues that stock of mutual funds is sold to persons all over the country and that the industry is a "fourteen-billion dollar industry" (P. Pet., p. 12).

Granting all of this the question remains whether or not the Act is in fact as petitioner asserts "a Federal Corporation Code, superimposed on state law, regulating the internal affairs of every corporation engaged in the mutual fund business", and that it imposes "new standards of responsibility for both inside and disinterested directors, new duties in safeguarding and preventing self dealing operations" (P. Pet., pp. 15, 26). Did Congress by the Act create federal statutory director duties, the violation of which gives rise to director liability whenever the Act is violated by a mutual fund? Conversely when the Act is violated by a mutual fund, are the directors responsible and liable under federal law and in Federal Courts?

The opinion of the Court of Appeals correctly answered these questions in the negative, and its opinion amply supports its conclusion.

When Congress wanted to create statutory duties beyond common law duties and personal liability respecting directors it did so, not by implication, but by precise language. For example, the National Bank Act provides (15 U. S. C., § 93):

> "§ 93. Violation of provisions of chapter; forfeiture of franchise; personal liability of directors.
>
> If the directors of any national banking association shall knowingly violate, or knowingly permit any of the officers, agents, or servants of the association to violate any of the provisions of this chapter, all the rights, privileges, and franchises of the association shall be thereby forfeited. Such violation shall, however, be determined and adjudged by a proper district or Territorial court of the United States in a suit brought for that purpose by the Comptroller of the Currency, in his own name, before the association shall be declared dissolved. And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation. R. S., § 5239; Mar. 3, 1911, c. 231, § 291, 36 Stat. 1167."

The foregoing federally created statutory liability is precisely the kind of liability petitioners seek by implication to import into the Investment Company Act. To do so would cause the Federal Courts to embark upon an immense task of fashioning a body of federal law to settle the multitude of questions certain to arise. What statute of limitations would apply? Is there joint and several liability? If so, is there contribution? What degree of care, ordinary, gross or willful is applicable? Does violation equal liability, per se, or is violation prima facie evidence of negligence?

Although the Safety Appliance Act was involved, the principle enunciated by this court in Gilvary v. Cuyahoga Valley Railway Company, 292 U. S. 57, 78 L. Ed. 1123, l. c. 1127, is applicable. This court held:

> "Unless excluded by congressional enactment under the commerce clause, state law governs the respective liabilities and rights of railroad carriers and their employees growing out of injuries suffered by the latter whether in interstate or intrastate commerce. (Citing cases.) The power conferred upon the Congress is such that when exerted it excludes and supersedes state legislation in respect of the same matter. But Congress may so circumscribe its regulation as to leave a part of the subject open to state action. (Citing cases.) The purpose exclusively to regulate need not be specifically declared. (Citing cases.) But ordinarily such intention will not be implied unless, when fairly interpreted, the Federal measure is plainly inconsistent with state regulation of the same matter. (Citing cases.)
>
> The Safety Appliance Acts govern common carriers by railroad engaged in interstate commerce. The Act of 1893 applied only to vehicles used by them in moving interstate traffic. U. S. C., title 47, § 2. Its requirements were by the Act of 1903 extended to all their vehicles. (Citing cases.) So far as the safety equipment of such vehicles is concerned, these Acts operate to exclude state regulation whether consistent, complementary, additional, or otherwise. (Citing cases.) The imposition of penalties (id., § 6) and abrogation of assumption of risk (id., § 7) are measures for enforcement.
>
> A violation of the Acts is a breach of duty owed to an employee, whether he is at the time engaged in interstate or intrastate commerce. And by abolishing assumption of risk the Acts impliedly recognize the

right to recover for injuries resulting therefrom. But the absence of a declaration similar to that in the Federal Employer's Liability Act, which denounces contracts and other arrangements made for the purpose of exempting carriers from liability created by that Act (U. S. C., title 45, § 55), strongly suggests a lack of legislative purpose to create any cause of action therefor. Moreover, if there had been such purpose, Congress probably would have included provisions in respect of venue, jurisdiction of courts, limitations, measure of damages and beneficiaries in case of death."

Congress refrained from expressly creating any private actions and hence did not incorporate limitation, contribution, joint and several liability and like provisions into the Investment Company Act with one exception. Section 30 (f) [15 U. S. C. A. 80a-29 (f)], of the Investment Company Act relating to self dealing in a fund's securities provides that a director, among others, is subject to the same duties and liabilities as those imposed by Section 16 (b) of the Securities Exchange Act of 1934 [15 U. S. C. A. 78p (b).] This section in creating the private civil action is specific. It says:

"78p (b) For the purpose of preventing the unfair use of information which may have been obtained by such . . . director, . . . by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . shall inure to and be recoverable by the issuer . . . Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after re-

quest or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized." . . . [15 U. S. C. A. 78p (b).]

No other private civil actions are provided for anywhere in the Act, except those authorized to be brought by the Securities and Exchange Commission.

The Congressional approach in situations respecting federally created liabilities of directors under Securities Acts is well illustrated by the discussion of the Court of Appeals in Martin v. Hull, 92 F. 2d 208. The Court was considering director liability under the Securities Act of 1933, which expressly by its terms makes a director liable to purchasers when a registration statement contains untrue statements. [Securities Act of 1933, § 11 (a, c), § 11 (b) (3) (c), as amended, 15 U. S. C. A., § 77k (a, c), § 77k (b) (3) (c)]. Referring to the House Committee Reports the court stated, l. c. 210:

"According to the statement of the House conferees accompanying the Conference Report on the bill, 'a point of difference between the House bill and the Senate amendment concerned the civil liability of persons responsible for the flotation of an issue. The Senate amendment imposed upon the issuer, its directors, its chief executive and financial officers, a liability which might appropriately be denominated as an insurer's liability. They were to be held liable without regard to whatever care they might have used for the accuracy of the statements made in the registration statement. The House bill, on the other hand, measured liability for these statements in terms of reasonable care, placing upon the defendants the duty, in case they were sued, of proving that they had used reasonable care to assure the accuracy of these statements. The standard by which reasonable

care was exemplified was expressed in terms of a fiduciary relationship. * * * In choosing between these two standards of liability, the Senate accepted the standards imposed by the House bill.' This standard in the 1933 act is set forth in section 11 (c) (48 Stat. 82) as follows: 'In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a person occupying a fiduciary relationship.'

"The standard of reasonable care was restated in the Securities Exchange Act of 1934, which amended section 11 (c) to read as follows: '(c) In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.' [15 U. S. C. A., § 77k (c)]."

The foregoing emphasizes that when Congress enters the field of director responsibility it does so by specific language. It is mindful of the kind of liability it imposes, who may sue and the defenses to be available to directors. Reference to the corporation acts of the states shows that by these codes director liability for corporate acts is the subject matter of detailed legislation spelling out the duty, the degree of care, joint liability, rights of contribution and like provisions. (Vol. 2, Model Business Corporation Act Annotated, American Bar Foundation, page 2, § 43.)

When this court considered the Labor Management Relations Act of 1947 (61 Stat. 156, 29 U. S. C., § 185), and concluded that this legislation created federal rights such as to require the fashioning of federal law, it considered

the Senate Reports and noted specific references to "a right of action in the Federal Courts" (Textile Workers Union of America v. Lincoln Mills of Alabama, 353 U. S. 448, 1 L. Ed. 2d 972, l. c. 978, 77 S. Ct. 912). The Court of Appeals in Brouk concluded and held that the legislative history of the Investment Company Act not only does not point to Congressional intent to create federally protected rights for mutual funds against their directors, but to the contrary indicated a Congressional intent not to enter the field of director liability. This field was left to the respective laws of the several states. That Fund has available its state law remedies is evident from the three common law counts of its complaint.

The Court of Appeals limited its decision to the narrow fact question presented by the amended complaint and amply demonstrated the correctness of its holding that Congress refrained from entering the field of director liability, and the Investment Company Act did not justify implying director duties and implying federal jurisdiction of private civil actions of the kind presented by Fund's complaint.

II.

The Decision of the Court of Appeals for the Eighth Circuit in Brouk et al. v. Managed Funds, Inc., et al., 286 F. 2d 901, Involving the Investment Company Act of 1940 Does Not Conflict With the Decision of the Court of Appeals for the Second Circuit in Goldstein v. Groesbeck, 142 F. 2d 422, Involving the Public Utility Holding Company Act of 1935.

Where a petition for certiorari is sought to resolve an alleged conflict between Courts of Appeal there must in fact be a conflict. (Layne & Bowler Corporation v. Western Mill Works, 261 U. S. 387, 43 S. Ct. 422, 67 L. Ed. 712.)

While it is true as petitioner points out that the jurisdictional sections of the Public Utility Holding Company Act and the Investment Company Act of 1940 are the same, there are many material differences in their provisions as would be expected since the Acts regulate different industries. The facts involved in the Bronk and Goldstein cases are not comparable. The questions decided are different as will be apparent from analysis of the Goldstein case.

In the Goldstein case Dora Goldstein, as shareholder of American Power and Light Company, brought a stockholder's derivative action in the District Court for the Southern District of New York against Electric Bond & Share Company, the top holding company of a public utility system, and twenty-two officers and directors of Electric Bond and its subsidiary, Ebasco Services, Incorporated, and nineteen corporate defendants. The action was brought in the right of four operating companies alleged to have contracted with Ebasco for construction and services in violation of the Holding Company Act which made service and construction contracts with unregistered holding companies void. An accounting for profits received by Ebasco was sought from it and Electric Bond and certain of their officers and directors.

Five individual and four corporated defendants moved to dismiss "on the ground, as to them, the venue was not properly laid in the Southern District of New York." These motions were granted except as to two individuals, residents of New York. The remaining defendants then moved to dismiss on the ground indispensable parties were lacking. The District Court thereupon dismissed the complaint.

On appeal the court reversed. It held that plaintiff as a stockholder could maintain a double derivative action in the Federal Court as a stockholder of the parent corpora-

tion in the right of its subsidiaries. It then held that the action was properly brought under the Holding Company Act under the void contract section. Venue, said the court, was therefore governed by section 25 of the Act and was properly laid in the Southern District of New York because contrary to the District Court's holding some of the acts under the void contracts occurred in that district (142 F. 2d, l. c. 425-6).

Aside from the recital in the opinion that there were director defendants of Electric Bond and Share and its subsidiary, Ebasco, there is no discussion of director liability. The averments of the complaint respecting directors do not appear. The complaint was not attacked for lack of federal jurisdiction of the subject matter. No such question was presented or decided. Such being the case the asserted conflict of the Bronk case with the Goldstein case is non existent and illusory.

In Brown v. Bullock, the recent decision of the District Court of New York, much relied on by petitioner, there was involved a combined derivative and shareholder class action by a shareholder of a mutual fund against its directors, investment adviser and underwriter for alleged violations of the Investment Company Act (C. C. H. Federal Securities Law Reporter Current Par. 91013, page 97354). Unlike the Bronk case the complaint charged arbitrariness, collusion, gross negligence and reckless disregard of duty on the part of the individual directors, and that there was an unlawful and willful conversion by them. No such question is presented by petitioner's amended complaint which is not a class action by shareholders. The distinction between Fund's complaint and a shareholder's action is a matter of legal substance and significance as was noted by Judge Medina in Howard v. Furst, 238 F. 2d 790, l. c. 793, wherein the court held the 1934 Securities Exchange Act created no federal jurisdiction respecting

corporate actions against directors. As petitioner has stated, the Brown case is on appeal and the decision of the District Court is not final. The conclusion of the District Court that the legislative history of the Investment Company Act shows a Congressional intent from which there can be implied private civil actions within the jurisdiction of Federal Courts against directors of mutual funds is erroneous as has been demonstrated in this brief and by the opinion in the Bronk case.

Respondents agree with petitioners and the accepted rule announced by this court that the Federal Rules permit notice pleading and complaints are not to be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts which would entitle plaintiff to relief. Equally well settled by this court is the requirement that jurisdiction must affirmatively appear. The principle is stated in Thomas v. Ohio State University Trustees, 195 U. S. 207, 25 S. Ct. 24, 49 L. Ed. 160, l. c. 163, as follows:

> "That the jurisdiction of a circuit court of the United States is limited in the sense that it has no jurisdiction except that conferred by the Constitution and laws of the United States; that a cause is presumed to be without its jurisdiction unless the contrary affirmatively appears; that such jurisdiction, or the facts upon which, in legal intendment, it rests, must be distinctly and positively averred in the pleadings, or should appear affirmatively and with equal distinctness in other parts of the record, it not being sufficient that jurisdiction may be inferred argumentatively; and that, for the purposes of suing and being sued in a circuit court of the United States, the members of a local 'corporation' are conclusively presumed to be citizens of the state by whose laws it was created, and in which alone the corporate body

has a legal existence,—are propositions so firmly established that further discussion of them would be both useless and inappropriate."

The pleader must point not just to a federal statute, but to a federal statute creating federal duties and rights of action in Federal Courts. This, respondents assert, petitioner has failed to do. Its claim of jurisdiction is based on two implications—first, that federal director duties are implied, and—second, that a private federal civil action is implied. Doubts are resolved against jurisdiction not in favor of jurisdiction.

CONCLUSION.

In conclusion, petitioners respectfully submit that for the reasons set out in this brief and those expressed by the Court of Appeals in its opinion the petition for the writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX 1.

Statutes Involved.

Investment Company Act of 1940, Section 30 (f), 54 Stat. 836; 15 U. S. C. A. 80a-29:

> "Reports and financial statements of investment companies and affiliated persons
>
> (f) Every person who is directly or indirectly the beneficial owner of more than 10 percentum of any class of outstanding securities (other than short-term paper) of which a registered closed-end company is the issuer or who is an officer, director, member of an advisory board, investment adviser, or affiliated person of an investment adviser of such a company shall in respect of his transactions in any securities of such company (other than short-term paper) be subject to the same duties and liabilities as those imposed by section 78p of this title upon certain beneficial owners, directors, and officers in respect of their transactions in certain equity securities. Aug. 22, 1940, c. 686, Title I, § 30, 54 Stat. 836."

Securities Exchange Act of 1934, Section 16 (b), 48 Stat. 896; 15 U. S. C. A. 78p:

> "§ 78p. Directors, officers, and principal stockholders
>
> (b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security

was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Securities Exchange Act of 1934, Section 18, 49 Stat. 1379, 15 U. S. C. A. 78r:

"§ 78r. Liability for misleading statements

(a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading)

who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

(b) Every person who becomes liable to make payment under this section may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment.

(c) No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued. June 6, 1934, c. 404, § 18, 48 Stat. 897, May 27, 1936, c. 462, § 5, 49 Stat. 1379."

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 196[illegible].

No. [illegible]87

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

BRIEF IN OPPOSITION

for

Respondents, Jacob Baker and George H. Shields, III.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1960.

No. 947.

MANAGED FUNDS, INCORPORATED,
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vs.

J. JOHN BROUK et al.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

BRIEF IN OPPOSITION

for

Respondents, Jacob Baker and George H. Shields, III.

OPINION BELOW.

The District Court overruled (R. 29-31) without opinion the motion of respondents Baker and Shields (R. 38[1]) and of other respondents (R. 21-24) to dismiss the complaint for want of jurisdiction of the subject matter.[2] The Court of Appeals reversed the District Court, and its opinion is reported at 286 F. 2d 901.

[1] The text of the motions of Respondents Baker and Shields was omitted from the record in the Court of Appeals because the motions were substantially similar to those filed by other respondents.

[2] The motions of Respondents Baker and Shields also raise a question of jurisdiction of the person; however, personal service was later had on Shields (but not on Baker) in the district of the district court.

JURISDICTION.

Jurisdiction of this Court rests on 28 U. S. C. 1254 (1).

INTRODUCTORY.

This brief, filed on behalf of certain respondents who prevailed below, seeks to persuade the Court that there is no occasion for granting certiorari.

Another brief in opposition is being filed by Respondents Brouk, Rebstock, Rice, Roberts and Mullen. With respect to the District Court's jurisdiction of the subject matter, which is the issue to which the petition for certiorari is addressed, Respondents Baker and Shields occupy precisely the same position as the Brouk group. We therefore adopt the statements and arguments made in the Brouk brief, but we wish to supplement that brief:

First, by our own formulation of the "Questions Presented";

Second, by additional argument.

QUESTIONS PRESENTED.

We believe that the petition for certiorari inadequately states the questions presented. We submit that, correctly stated, the questions are:

A. Where a corporation's complaint states a claim[1] of director misconduct under state law, does the case become one "arising under" the laws of the United States merely because the complaint includes allega-

[1] The complaint alleges that the directors aided, abetted, and committed actual or statutory violations. No concession is intended that mere knowledge would give rise to liability, nor that plaintiff has been damaged.

tions that the directors **caused the Company to violate a federal statute**, or are those allegations "mere excrescence or superfluity tacked on to what are otherwise sufficient allegations of a claim for relief under (state) law"?[1]

B. If the question A be answered in favor of the plaintiff-petitioner, does the Investment Company Act of 1940[2] create in favor of an investment company a private right of action, against former directors who are alleged **to have caused the company** to violate the Act but who are not alleged to have personally violated any express command of the Act?

It will be observed that the Petition does not even suggest the presence in this case of Question A.

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[1] See opinion of Judge Medina in *Hazard v. Furst*, 238 F. 2d 700 at 704 (2d Cir., 1956), affirming 140 F. Supp. 507, cert. den. 353 U. S. 937.

[2] 15 U. S. C., Secs. 80a-1 et seq.

ARGUMENT.

1. Construction of the Investment Company Act of 1940 was not necessary to the decision by the Court of Appeals.

While the Court of Appeals appears to have rested its decision on the ground that the Investment Company Act of 1940 does not subject directors to "strict liability as insurers," its decision could equally well be sustained on the ground that the case **does not arise under** the laws of the United States.

The complaint in this case charges certain managing directors (who are distinct from the "outside"[3] directors, some of whom are respondents here) with having engaged in numerous violations of their fiduciary duties and with having profited handsomely thereby.[4] The "outside" directors, including respondents, are charged with having had actual or constructive knowledge of the insiders' misconduct, and with having "committed, or with actual or constructive knowledge, aided, abetted, acquiesced in or condoned"[2] violations of the Investment Company Act by the corporation.

Since the Court of Appeals could have found that the complaint states a cause of action against the outside directors **under state law**, this Court is faced squarely with the question whether the case is one arising under the laws of the United States. The reason why this question is presented is illustrated by **Howard v. Furst**, 238 F. 2d 790 (2d Cir., 1956), affirming 140 F. Supp. 507, cert. den. 353 U. S. 937, where a stockholder in Circle Wire & Cable Corporation complained of misleading statements made in

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[3] Paragraph 6 of Complaint (R. 3).

[4] The managing directors answered over without raising the question of jurisdiction.

[2] Paragraph 21 of Complaint (R. 6).

that corporation's proxy statement relating to a proposed sale of its assets and sought in a derivative action to invoke private rights under Section 14 (a) of the Securities Exchange Act of 1934[1] and the Commission's proxy rules issued thereunder. Judge Medina's opinion says in part (pp. 793-4):

> "We turn to the subject of jurisdiction over subject matter. For, if appellant's claim is presented in a case 'arising under' the laws of the United States, a dismissal for lack of jurisdiction is not warranted solely because the interpretation of the federal statue relied upon turns out to be wrong. Accordingly, we shall now examine the allegations of the complaint in order to determine whether, as found by the court below, appellant's claim is for violation of state-created rights, in no real or substantial sense dependent upon the provisions of the Securities Exchange Act of 1934 relative to proxy statements.
>
> "The controlling authority is Gully v. First National Bank in Meridian, 299 U. S. 109, 57 S. Ct. 96, 81 L. Ed. 70, where Mr. Justice Cardozo restates what had long been settled law, to the effect that the federal right relied upon must be an essential element of plaintiff's claim, that it must be of such a character that it will be supported if the federal law is given one construction or effect, and defeated if it receives another. He adds 299 U. S., at page 118, 57 S. Ct. at page 100:
>
> > "'As in problems of causation, so here in the search for the underlying law. If we follow the ascent far enough, countless claims of right can be discovered to have their source or their operative limits in the provisions of a federal statute

[1] 15 U. S. C., Sec. 78n.

> or in the Constitution itself with its circumambient restrictions upon legislative power. To set bounds to the pursuit, the courts have formulated the distinction between controversies that are basic and those that are collateral, between disputes that are necessary and those that are merely possible. We shall be lost in a maze if we put that compass by.'

"Applying this test it is clear to us that every essential element of appellant's case depends upon the common law and the statutes of the State of New York. If the individual defendants who controlled 60.68% of Circle's outstanding stock, in violation of their fiduciary duties as directors and officers of Circle, brought about a sale of Circle's assets for a grossly inadequate sum, all in furtherance of their personal and private interests, the case would be ripe for judgment for rescission of the sale or for damages, wholly irrespective of whether some or all of the individual defendants had participated in the formulation and sending out of a false or misleading proxy statement. The allegations with reference to the proxy statement constitute a mere excrescence or superfluity tacked onto what are otherwise sufficient allegations of a claim for relief under New York law.

"The controversy as to the interpretation to be given Section 14 (a) is, therefore, not basic but collateral to appellant's case."

From the foregoing it follows that:

The decision below is supportable independently of interpretation of the Investment Company Act of 1940.

If certiorari were granted for the purpose of settling the interpretation of the Investment Company Act of 1940, this Court might never reach that issue.

2. The decision below was correct on the grounds stated by the Court of Appeals.

The Securities Act of 1933,[1] the Securities Exchange Act of 1934,[2] and Sections 16 (a) and 17 (b) of the Public Utility Holding Company Act of 1935[3] each made **express provision** for private civil litigation. By contrast, the Investment Company Act of 1940[4] makes no such provision. In **Pennington v. Coxe**, 2 Cranch 33 (1804), Chief Justice Marshall said:[5]

> "Where the legislature distinguishes between different objects, and in imposing a duty on them evidences a will to charge them in different situations, it is not for the courts to beat down these distinctions on the allegation that they are capriciously made, and therefore to be disregarded. It is the duty of the court to discover the intention of the legislature, and to respect that intention. Where the provisions of two acts are so unlike each other, that the comparison exhibits only a contrast, instead of saying that their opposing regulations were designed to be similar, it would seem much more reasonable to say that the one act exhibits a legislative mind materially variant in the particulars where the difference exists from what is exhibited by the other."—2 Cranch at 59.

Moreover, it was not until 1941 (the year after adoption of the Investment Company Act) that any court saw fit to

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[1] 15 U. S. C., Secs. 77k, 77l, and 77o.

[2] 15 U. S. C., Secs. 78i (e), 78p (b), 78r (a), and 78t (a).

[3] 15 U. S. C., Secs. 79p (a) and 79q (b).

[4] 15 U. S. C., Secs. 80a-1 et seq.

[5] The case held that an excise tax on refined sugar became payable not when the sugar was refined but only when the refined sugar was shipped from the refinery. Chief Justice Marshall rejected the government's attempted analogy of the tax on distilled spirits, which became payable as of the time of distillation.

find in any of the federal securities laws an implied private right of action. Accordingly, in 1940 Congress could not have been mindful of any such interpretation of the earlier securities acts.

It may be conceded that the Investment Company Act was intended to protect both the public interest and the interest of investors. However, the regulatory scheme of the Act is primarily one of imposing restrictions on the activities of investment companies. The prohibitions which might have some application to directors (being phrased in terms of "no person . . .") are incidental to the main current of the statute. Drafting of the Act received long and expert attention from the staff of the Securities and Exchange Commission. Except for the prohibition in Section 80a-17 against self-dealing and authority given the SEC by Section 80a-35 to proceed against a director for gross abuse of trust, regulation of the conduct of directors was intentionally omitted. The Congress rejected the notion of any drastic revision of managerial responsibility. (See opinion below at Pet. Brief, p. 51). To find a civil remedy under these circumstances would be pure invention.[1]

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[1] As the Court of Appeals points out (Pet. Brief, p. 48, note 1), had Congress intended to authorize private civil actions against directors of investment companies, it could easily have followed the well traversed road of national bank legislation, which doesn't leave the matter to chance:

> 12 U. S. C., Sec. 93: "If the directors of any national banking association shall knowingly violate, or knowingly permit any officers . . . to violate any of the provisions of this chapter, all the rights, privileges, and franchises of the association shall be thereby forfeited . . . And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person shall have sustained in consequence of such violation."
>
> 12 U. S. C., Sec. 73: "Each director . . . shall take an oath that he will . . . diligently and honestly administer the affairs of such association, and will not knowingly violate or willingly permit to be violated any of the provisions of this chapter . . ."

3. **No important federal question is involved.**

This petition for certiorari does not present an important question of federal law calling for determination by this Court.

The Investment Company Act became law in 1940. Already at that time investment companies (mutual funds) constituted an important segment of the securities market. However, in two decades there has been relatively little litigation under the Investment Company Act.

The importance of a decision of this controversy by the Supreme Court should be measured by its consequences. As has been argued above, if certiorari were to be granted, this Court might well decide the case on a ground not involving interpretation of the Investment Company Act. However, even assuming that the Court would reach the issue of interpretation of that Act, what would the consequences of decision be?

If the decision below were to be reversed and federal jurisdiction were to be upheld, it will mean no more than that federal courts have concurrent jurisdiction with state courts for acts of directors which, even without this Act, would generally constitute violations of fiduciary duties under the common law of the several states, and that mutual funds would enjoy the convenience, and their directors be subjected to the inconvenience, of the "long arm" service of process provided for in the Act. On the other hand, if the decision below were to be affirmed and federal jurisdiction denied, as we think it should be, investment companies with rights of action against their directors for nonfeasance or malfeasance will be relegated to their wholly adequate remedies in the state courts.

4. **There is no conflict of decisions.**

The brief in opposition of Respondents' Brouk et al. adequately shows that the pretended conflict with **Goldstein v. Groesbeck**, 142 F. 2d 422 (2d Cir., 1944), does not exist.

Respectfully submitted,

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No. [illegible] 87

In the Supreme Court of the United States

OCTOBER TERM, [illegible]

MARGARET PUTNAM, ET AL., PETITIONERS

v.

J. JOHN BRUCE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE [illegible] CIRCUIT

BRIEF FOR THE OPPOSITION AND CONDITIONAL CROSS-PETITION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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In the Supreme Court of the United States

OCTOBER TERM, 1960

No. 908

MANAGED FUNDS, INC., PETITIONER

v.

J. JOHN BROUK, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the court of appeals (Pet. 29–64) is reported at 286 F. 2d 901. The order of the district court is unreported.

JURISDICTION

The judgment of the court of appeals was entered on January 13, 1961. The motion for rehearing was denied on March 6, 1961. The petition for a writ of certiorari was filed on May 8, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a private right of action will lie for violation of the Investment Company Act of 1940.

STATUTE INVOLVED

Pertinent sections of the Investment Company Act of 1940, 15 U.S.C. 80a–1, *et seq.*, are reproduced in the appendix to the petition, pp. 67–73.

STATEMENT

Petitioner, Managed Funds, Inc., is an open-end investment company[1] registered under the Investment Company Act of 1940 (hereinafter referred to as "the Act"). Managed Funds filed a complaint on May 29, 1959, and an amended complaint on October 23, 1959, in the United States District Court for the Eastern District of Missouri seeking an accounting, injunctive relief, and money damages from its former directors, its investment advisers, Slayton Associates, Inc., and one Jaquith, its brokers, Model, Roland & Stone, and others (see Pet. 6) for alleged violations of the Act.[2]

The complaint alleges that Managed Funds contracted with Slayton Associates, Inc., to act as its investment adviser for an annual fee of ½ of 1% of the value of Managed Funds' assets (R. 4, 14); that

[1] Section 5(a)(1) of the Act (15 U.S.C. 80a-5(a)(1)) defines an open-end investment company as "a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer."

[2] Josephson, a shareholder of Managed Funds, had previously filed a derivative action in the District Court for the District of Delaware in which he requested the same relief as that requested in the action initiated by Managed Funds. The Josephson action was subsequently transferred to the Eastern District of Missouri and consolidated with the Managed Funds action.

Respondents in this Court are the so-called "independent" directors of Managed Funds. The other defendants did not appeal, and therefore the action as to them is still pending in the district court.

Slayton Associates accepted fees at that rate, totalling over $1,000,000 over a six-year period, for which it performed no services, having delegated to Jaquith its duties as investment adviser to Managed Funds (R. 5, 15, 16); that Jaquith agreed to perform these duties for a minimum compensation of $50,000 a year for five years beginning in 1953 and a minimum of $35,000 a year for the next succeeding five years, payment to be effected through brokerage on Managed Funds' portfolio transactions (R. 5, 15); that Jaquith channeled Managed Funds' brokerage business to Model, Roland & Stone, a brokerage partnership of which Jaquith was a member, and that the partnership received brokerage commissions of more than $1,500,000 (R. 5); that Jaquith and Model, Roland & Stone paid in excess of $50,000 a year to each of two named individuals (one is a former director of Managed Funds and the other is a brother-in-law of Hovey E. Slayton, an officer of Slayton Associates) for which no services were performed (R. 5).

The complaint further alleges that Managed Funds' investment policy as announced in its prospectuses was to provide capital growth, as well as reasonable income consistent with such a growth policy (R. 4); that, after the arrangement was entered into with Jaquith, this policy was not followed, but distributions to shareholders of a predetermined income were made; that to make such distributions capital gains had to be realized; that this was accomplished by excessive portfolio transactions; that Jaquith and his partners in Model, Roland & Stone thereby made greater commissions and the fund sold

many of its best capital growth holdings, which in a number of instances were immediately repurchased at a higher price (R. 5, 6, 16).

The complaint also alleges that Managed Funds may be liable to purchasers of its shares by reason of the false statements contained in Managed Funds' registration statements; that stop order proceedings against Managed Funds have been instituted by the Securities and Exchange Commission as a result of those false statements and that Managed Funds was thereby damaged (R. 6–8). The complaint alleges finally that Slayton Associates, Jaquith, and Model, Roland & Stone occupied a fiduciary relation to Managed Funds which relation was breached through mismanagement and waste of Managed Funds' assets (R. 9, 10, 19); and that the "independent" director defendants of Managed Funds had knowledge both of this fiduciary relation and of the mismanagement and waste, but failed to take any action to prevent it (R. 6, 10).

The district court denied the defendants' motions to dismiss. On appeal under the interlocutory appeals statute (28 U.S.C. 1292(b)) to the United States Court of Appeals for the Eighth Circuit, the judgment of the district court was reversed on the ground that the Investment Company Act provides for no civil remedies. A petition for rehearing was denied by the court of appeals. A motion of the Securities and Exchange Commission requesting leave to file a memorandum as amicus curiae on the rehearing was also denied.

REASONS FOR GRANTING THE WRIT

1. This case raises a question of great public importance—whether the Investment Company Act by implication gives rise to a right of action by shareholders of investment companies for violation of the Act. As of March 30, 1961, the open-end investment companies, generally referred to as "mutual funds," alone had over five million shareholder accounts totaling approximately 19½ billion dollars in net asset value. The average account was less than $3,900. Congress stated in the Investment Company Act that certain investment company practices adversely affect the national public interest as well as the interests of investors, including as one such practice: "when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers * * * [or] in the interest of underwriters, brokers, or dealers, * * * rather than in the interest of all classes of such companies' security holders" (Section 1(b), 15 U.S.C. 80a–1(b)).

The complaint in this case allages in detail that an investment company, which is registered and covered by the Investment Company Act, has been operated and managed in the interest of its directors, officers, investment advisers and brokers rather than in the interest of its security holders. Despite these allegations that respondents have violated the duties and standards prescribed in the Act, the court below held that the federal courts did not have jurisdiction to provide a remedy. Thus, the holding below would

deprive investment company shareholders of virtually any remedy under the Investment Company Act.

Moreover, the decision below will have a broad impact on presently pending litigation. There are approximately fifty suits now pending in various state and federal courts involving eighteen registered investment companies. Approximately twenty of the suits which are pending in federal courts raise the question of whether a right of action flows from violation of the Act. Some of the state court actions also raise this federal problem. The numerous cases now pending in the lower courts make an early resolution of this issue in this Court highly desirable.

2. The decision below is in conflict with the principles enunciated in numerous courts of appeals' decisions under the other federal securities laws. The courts of appeals have repeatedly sustained an implied private right of action for violation of the provisions of the Securities Exchange Act of 1934. Section 6(b): *Baird* v. *Franklin*, 141 F. 2d 238, 245 (C.A. 2). Section 10(b): *Slavin* v. *Germantown Fire Ins. Co.*, 174 F. 2d 799 (C.A. 3); *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (C.A. 2); *Fratt* v. *Robinson*, 203 F. 2d 627 (C.A. 9); *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808 (D. Del.), affirmed, 235 F. 2d 369 (C.A. 3); *Errion* v. *Connell*, 236 F. 2d 447 (C.A. 9); *Matheson* v. *Armbrust*, 284 F. 2d 670 (C.A. 9); *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C.A. 5); *Reed* v. *Riddle Airlines*, 266 F. 2d

314, 315 (C.A. 5).[3] Similarly in *Goldstein* v. *Groesbeck*, 142 F. 2d 422, certiorari denied, 323 U.S. 737, the Second Circuit upheld a private right of action involving the application of provisions in the Public Utility Holding Company Act of 1935 similar to those in the Investment Company Act involved in this case.[4] In these holdings, the courts of appeals have followed the decisions of this Court (in cases not involving securities statutes) that private rights of action flow from violation of a federal statute in favor of those whom the statute is designed to protect.[5] We submit that these private rights of action

[3] The only court of appeals' decision suggesting the contrary is *Howard* v. *Furst*, 238 F. 2d 790 (C.A. 2), involving Section 14 of the 1934 Act. This case is distinguished on several grounds in *Brown* v. *Bullock* (S.D.N.Y.), decided March 9, 1961, now pending an appeal before the Court of Appeals for the Second Circuit (copies of which we have filed with the clerk). See opinion, pp. 46–51.

[4] The court below purported to distinguish *Goldstein* by pointing out that in the instant case the defendant directors did not profit and were not in privity of contract (Pet. 54–56), but this was also true as to the director defendants in *Goldstein*. The invalid contracts in that case were between the holding company defendants on the one side and four operating companies on the other and the profit went to the two corporate defendants. See also *infra*, p. 13.

[5] See, *e.g.*, *Texas & Pacific Ry Co.* v. *Rigsby*, 241 U.S. 33, 39; *Bell* v. *Hood*, 327 U.S. 678, 684; *A. C. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 312 U.S. 38, 43; Restatement of the Law of Torts, § 286. In the *Texas & Pacific* case this Court stated: "A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied * * *" (241 U.S. at 39). In *Bell* v. *Hood*, the Court

are especially appropriate in the investment company area because of the great measure of trust and confidence necessarily involved in the investor's relations with his company's management. The reasoning which underlies the implication of private rights of other federal securities law provisions thus applies with redoubled force to violations of the Investment Company Act.

The decision below is directly in conflict with several holdings of the district courts that the Investment Company Act gives rise to an implied private right of action. *Brown* v. *Bullock, supra;* * *Schwartz* v. *Bowman,* 156 F. Supp. 361 (S.D. N.Y.), appeal dismissed on other grounds *sub nom. Schwartz* v. *Eaton,* 264 F. 2d 195 (C.A. 2); *Cogan* v. *Johnston,* 162 F. Supp. 907 (S.D. N.Y.); see also *Taussig* v. *Wellington Fund,* 187 F. Supp. 179 (D. Del.); *Breswick & Co. v. Briggs,* 136 F. Supp. 301 (S.D. N.Y.). In *Brown* v. *Bullock,* the district court specifically refused to follow the decision below. Moreover, in *Schwartz* v. *Eaton,* the court of appeals commented favorably upon the district court's determination in

held that: "* * * where federally protected rights have been invaded, it has been the rule from the beginning that courts will be alert to adjust their remedies so as to grant the necessary relief" (327 U.S. at 684).

* This case was argued before the Second Circuit sitting *en banc* on May 22, 1961, and is awaiting decision.

that case sustaining an implied federal private right of action under the Investment Company Act.[7]

3. The court of appeals clearly erred in holding that the Investment Company Act is not properly construed to provide for a private right of action. Section 1 of the Act makes plain that Congress designed the Act for the protection of the investing public. Then, Section 44 of the Act (15 U.S.C. 80a–43) provides that "[t]he district courts of the United States * * * shall have jurisdiction of * * * all suits in equity and actions at law brought to enforce any liability or duty created by" this Act and that such suits or actions can be brought "in the district wherein the defendant is an inhabitant or transacts business." An identical provision was relied upon in *Goldstein* v. *Groesbeck, supra,* by the Second Circuit in holding that a private right of action was created by the Public Utilities Holding Company Act for violation of the duties imposed by that Act.

The complaint here plainly alleges violations of duties imposed by the Investment Company Act. First, Section 15(a) of the Act (15 U.S.C. 80a–15(a))

[7] The court of appeals said (264 F. 2d at 196): "In a reasoned decision * * * the district court held that the complaint * * * stated a claim under the Investment Company Act upon which relief can be granted." The court of appeals also stated (*id.* at 198, note 5): "That such remedies may be had under the Investment Company Act is made clear by the earlier part of Judge Dimock's decision, D.C. S.D.N.Y., 156 F. Supp. 361; and see *Brenwick & Co.* v. *Briggs*, D.C. S.D.N.Y., 136 F. Supp. 301; *Cogan* v. *Johnston*, D.C. S.D.N.Y., 162 F. Supp. 907." The issue before the Second Circuit involved other portions of Judge Dimock's decision.

makes it unlawful for any person to act as investment adviser of a registered investment company unless the contract has been approved by a majority of the shareholders of the company, and requires that the contract must provide "for its automatic termination in the event of its assignment by the investment adviser." Section 15(c) of the Act (15 U.S.C. 80a–15(c)) makes it unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract whereby a person undertakes to act regularly as an investment adviser unless the contract is approved either by a majority of the "independent" directors or a majority of shareholders. Moreover, Section 47 of the Act (15 U.S.C. 80a–46) renders void any contract which violates Section 15. Thus, the Investment Company Act clearly imposes a duty on directors of investment companies not to enter contracts offending Section 15—a duty which Section 44 states is enforceable in the federal courts.[9]

The complaint here alleges that respondents violated their duties under Section 15 of the Act. The initial advisory contract between Managed Funds and Slayton Associates was approved by Managed Funds' stockholders. The complaint states, however, that the contract of Managed Funds with Slayton Associates was automatically terminated by the assign-

[9] Section 15 is analyzed at considerable length in *Brown* v. *Bullock*, *supra* (see opinion, pp. 52–57). That opinion goes on to demonstrate that the Act makes directors liable for gross misconduct or abuse of trust (see opinion, pp. 57–78).

ment of the contract to Jaquith as provided in Section 15(a) and that no contract for Jaquith to act as investment adviser was ever approved by the stockholders of Managed Funds as Section 15(a) also requires (R. 7, 16). Nevertheless, the complaint alleges, Managed Funds' contract with Slayton Associates, Inc., was renewed by defendant directors, including respondents, who, as independent directors, had under Section 15(c) a particular responsibility in this matter. Moreover, the complaint claims, not merely that respondents had violated their fiduciary duty by failing to prevent Managed Funds from operating and making large payments (over 2½ million dollars) over a five-and-a-half-year period pursuant to void contracts (the 1 million dollars to Slayton Associates was also for services which were not performed), but that they knowingly approved of these actions (R. 6, 10).

Second, the complaint charges respondents with violation of their fiduciary duties under Sections 8(b) (15 U.S.C. 80a-8(b)) and 13(a) (15 U.S.C. 80a-13(a)) of the Act. Section 8(b) provides that registered investment companies must file with the Commission a registration statement including recitals of policy which the registrant deems fundamental. Section 13(a) provides that a registered investment company cannot "deviate from any fundamental policy recited in its registration statement pursuant to" Section 8(b).

The complaint in this case alleges that Managed Funds, in accordance with Section 8(b) of the Act, stated in its registration statements that its policy

was to provide for "capital growth" and, consistent with this policy, to seek reasonable income, the net investment income and any realized profits on the sale of securities to be distributed quarterly (R. 4). The complaint states that, after Jaquith became investment adviser to Managed Funds, the policy of capital growth was not followed. Instead, the policy was adopted of maintaining a predetermined amount of distributions and, if the investment income was insufficient, to realize capital gains from the sale of securities (R. 5–6). The result, the complaint says, was to "churn" Managed Funds' portfolio to the benefit of the defendant brokers and to the great loss of the Funds' portfolio (R. 6, 16, 17). The complaint further alleges that respondents, as directors of Managed Funds, had a fiduciary duty not to permit a deviation from the Funds' fundamental policy without the approval of a majority of shareholders, but that, instead, respondents knowingly participated in this plan (R. 6–7).

4. The court of appeals suggested two considerations in this case making an implied right of remedy particularly inappropriate. First, the court said that petitioners sought to make respondents absolute insurers (Pet. 64). In fact, however, the complaint charges respondents with knowledge of the violations of the Act. And, in any event, even if no actual knowledge were alleged, fiduciaries are often charged with violation of their fiduciary duties—whether in-

posed by common law or by statute—because of their failure to discover facts detrimental to the beneficiaries and to remedy the situation.

Second, the court emphasized that no privity of contract exists between the plaintiffs and defendants (Pet. 43). In fact, however, privity of course existed between Managed Funds, one of the plaintiffs, and its own directors. But, regardless, privity "is not a fixed condition precedent to the implication of a private remedy for a statutory violation that injured the plaintiffs, members of the protected class. * * * [Privity] is an evidentiary fact to be considered in conjunction with other material facts in determining whether the relationship (such as it is) between the plaintiffs and the defendants and the nature of the particular acts and transactions involve the duty created by the statute." *Brown* v. *Bullock, supra* (see opinion, p. 42).

In short, the complaint charges the respondents with knowing of, and indeed participating in, operations by Managed Funds which clearly violated provisions of the Investment Company Act and which resulted in great detriment to Managed Funds and its shareholders. We submit that, if the petitioners can prove their allegations, they will have made out a valid case under Section 44 of the Act.

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be granted.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1961.

No. 87.

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

BRIEF OF PETITIONER.

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1. Section 15 (a) provides that an advisory contract is in effect "only so long as such continuance is specifically approved at least annually by the board of directors." Section 15 (c) makes it ultra vires and illegal for a fund which has a board of directors to "renew" or "perform" any advisory contract without approval of a majority of the "unaffiliated" ("outside") directors. These sections impose duties (as to specific contracts of the corporation) of vigilance and due care on directors in making such extensions, and certainly the directors cannot knowingly extend and pay money to an adviser (i. e., "perform")

when the adviser's contract has been unlawfully assigned and the inside performs no services for the payments 34

2. Section 15 (a) makes it illegal under any circumstances to initially employ an adviser unless such contract is initially approved by shareholders. The directors have a duty under 15 (a) and 15 (c) to require the employment of the actual adviser to be submitted to stockholders for their approval or disapproval. They have a corresponding duty not to perform, pay out money, under such an unapproved contract 35

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1961.

No. 87.

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

BRIEF OF PETITIONER.

Writ of Certiorari was granted in this case to review the judgment of the United States Court of Appeals for the Eighth Circuit, which reversed orders of the District Court overruling motions of certain defendants to dismiss the complaint.

OPINIONS BELOW.

The District Court did not file an opinion. The opinion of the Court of Appeals is reported at 286 F. 2d 901.

JURISDICTION.

The judgment of the Court of Appeals (R. 72) was entered on January 13, 1961. On February 1, 1961 petitioner filed a petition for rehearing in the Court of Appeals, and on February 6, 1961, a motion of the Securities and Exchange Commission for leave to participate amicus curiae was filed. Petitioner's motion for rehearing and the motion of the Securities and Exchange Commission were denied on March 6, 1961.

Petitioner filed its Petition for Writ of Certiorari with this Court on the 6th day of May, 1961. Thereafter, the Securities and Exchange Commission filed its brief as amicus curiae in support of the Petition for Writ of Certiorari.

On the 19th day of June, 1961, this Court granted certiorari.

The jurisdiction of this Court rests on 28 U. S. C., Section 1254 (1).

STATUTE AND RULE INVOLVED.

The statute involved is the Investment Company Act of 1940 (Section 80a of Title 15, U. S. C.*), regulating the internal affairs and the investment advisory contracts of mutual funds. Section 1 (b) (2) declares that the evils at which the Act is directed include "inside" operation by directors who are self-interested advisers, or by salesmen or brokers having conflicts of interest, and that the Act is to prevent operation of such funds for the profit of

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* The section numbers of 80a correspond to the section numbers of the Act, until 80a-29, which is Section 30 of the Act, and from there on the corresponding section numbers of the Act are one digit above the section numbers set forth in 80a

such insiders, rather than for the investors; this purpose is a guide [1 (b)] in interpreting the Act, so as to mitigate or eliminate the evils enumerated. Sections 9 and 10 regulate the composition of boards of directors so as to limit the number of self-interested ("affiliated") advisers and brokers or underwriters who may serve on such boards.

Particularly relevant to this case are the following Sections of the Act: Section 15 requiring initial approval by shareholders of self-dealing contracts of advisers and underwriters and the extension thereof either by shareholders or by disinterested ("unaffiliated") directors; Violation of Section 15 makes such contracts illegal; Section 8 (b) (2), requiring the management to declare the fund's fundamental investment policies for information of investors; and Section 13 (a) (3), making deviation from such declared policies, without stockholder approval, illegal.

There is also an important substantive or remedial provision of the Act involved here: Section 47 (b) [Section 80a-46 (b) of Title 15, U. S. C.] which declares that contracts made in violation of the statutory provisions are "void", not merely voidable as in the case of "insiders" contracts at common law.

And there is the specific jurisdictional section of this Act, Section 44 (Section 80a-43 of Title 15, U. S. C.) further aiding in the enforcement of said provisions, which gives concurrent jurisdiction to State and Federal courts "of all suits in equity and actions at law brought to enforce any liability or duty created by the Act," and provides for long arm service of process for actions brought in the Federal Court.

Rule 8 (a) of the Federal Rules of Civil Procedure, which provides that plaintiff need only plead a short,

plain statement of facts setting forth its claim, is involved in the construction of the complaints.

These sections of the Act and the said rule are set forth in full in the Appendix.

QUESTIONS PRESENTED FOR REVIEW.

1. The first question presented is whether the Investment Company Act of 1940 imposes duties on the directors of a mutual fund registered thereunder, and if so, whether the breach of such duties, including their own participation in illegal action, gives rise to a civil cause of action, under Section 44 of the Act, by such a mutual fund against the directors in the District Court of the United States.

2. The second question is whether the complaints, which aver that these respondent directors knowingly participated in violations of the Act and breached their own statutory duties created by the Act, state a claim within the broad liberality afforded a pleader under Rule 8 (a) of the Federal Rules of Civil Procedure.

STATEMENT OF THE CASE.

Petitioner is a mutual fund registered as an investment company under the said Investment Company Act of 1940. Suits were brought by the Petitioner and by a stockholder on behalf of Petitioner against its former investment advisers, sales companies (underwriters), directors, and brokers in the United States District Court, for alleged violations of and breaches of duty created by the Investment Company Act of 1940. Jurisdiction was based on Section 44 of the Act.

Both suits were filed after public disclosures in "Stop-order Proceedings" before the Securities and Exchange Commission, in May of 1959.*

The first suit was a derivative stockholder's suit instituted in the United States District Court in Delaware by Emanuel Josephson on behalf of Managed Funds (R. 12). The second suit was instituted by Managed Funds itself in the United States District Court for the Eastern District of Missouri (R. 1). The Josephson case was thereafter transferred to the said District Court in Missouri (R. 13) and the causes consolidated (R. 28).

The complaints sought to recover (1) unearned advisory fees in excess of $1,000,000 paid to the Fund's disclosed adviser, (2) brokerage commissions in excess of $1,500,000 paid to the Fund's undisclosed and unapproved adviser (a brokerage firm which took over the official adviser's func-

* The Securities and Exchange Commission, on July 31, 1959, entered an order prohibiting Managed Funds from selling its stock. *In Re Managed Funds*, C. C. H. Fed. Sec. Law Rep., Current, Par. 76,662 (1959), for the reason, inter alia, that the Fund was operating with an unlawful investment adviser. The S. E. C. made this finding regarding respondent directors (p. 80,509):

> "On the basis of the record it is evident that the directors failed to discharge their duties and responsibilities as directors, and failed to perform the functions which the prospectus represented they were performing."

tions) for investment advice illegally rendered, and for brokerage transactions which were also illegal under Section 13 (a) (3) because they were contrary to the Fund's stated and fundamental investment policy, and (3) the Fund's damage in making said payments and for losses resulting from excessive brokerage transactions. The accountability for the said monies paid and the damages incurred were based upon alleged violations by defendants including respondent directors of the Investment Company Act of 1940, and for breaches of statutory duty imposed thereby.*

As above mentioned, jurisdiction was based on Section 44 of the Investment Company Act of 1940 (80a-43 of Title 15, U. S. C.) which provides that the "district courts . . . shall have jurisdiction of violations" of the Act, and of "all suits in equity and actions at law brought to enforce any liability or duty created by, or enjoin any violations of" the Act.

Respondents, who were certain of the defendant directors, moved to dismiss the action on the ground that there was no jurisdiction over the subject matter** for the reason that there were no duties of directors created by

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* The Managed Funds complaint contains three other counts: Count II (R. 8) asserts liability for losses under the Securities Act of 1933; Count III (R. 9) bases liability for breaches of fiduciary duties; and Count IV (R. 11) seeks recovery on the claim of a conspiracy. Count III reasserts jurisdiction under the Investment Company Act, but adds that "the unlawful and wrongful acts" constituted breaches of fiduciary duty at common law. Standing alone even without reference to the statute such counts may be joined with Petitioner's statutory claim. *Hurn v. Oursler*, 289 U. S. 238, 77 L. Ed. 1148, 53 S. Ct. 586 (1933).

** Certain of the respondents, who were non-residents, also asserted that there was no jurisdiction over their respective persons, since they were served with process by extra-territorial service as authorized by Section 44 of the Investment Company Act of 1940. The District Court also ruled against respondents on this phase of the motion. The Court of Appeals did not pass on this issue.

the Investment Company Act of 1940, and hence no remedy against them cognizable in the Federal District Court.

District Judge Randolph H. Weber overruled respondents' motions to dismiss the complaints (R. 28). After the Court of Appeals for the Eighth Circuit permitted respondents to appeal this interlocutory order under the new interlocutory appeal (Section 1292 (b), Title 28, U. S. C. (R. 39)), it reversed Judge Weber's rulings (R. 72) on the grounds that there were no statutory duties of directors under the Investment Company Act of 1940 nor any legislative intent in enacting said statute to impose statutory duties upon directors (R. 58-60), no remedy for breach (R. 60), and that the complaints, which alleged a knowing participation by directors in violations of the Act (R. 6, 19) only asserted "insurers" liability (R. 71).

Subject Matter and Terminology of the Act.

A brief description of the subject matter of this legislation seems to be desirable at this point, so that the issues presented herein are more easily understood.

The Investment Company Act of 1940 does not authorize or purport to create mutual funds, but rather, it is a regulatory statute imposing certain restrictions on the operation of mutual funds, as this investment business had developed by 1940—already a multi-billion dollar "industry." Mutual funds were commonly organized under state law in a corporate form (less frequently, in trust form) and were usually "organized" or "sponsored" by investment or brokerage houses (Jaretzki, "The Investment Company Act of 1940," Wash. U. L. Q. [April, 1941*]). The appeal of a fund—especially to small in-

* Mr. Jaretzki represented a group of closed-end investment companies at the Senate and House hearings on the investment company bill, and participated in certain negotiations which led to an agreement in regard to the drafting of the bill. The article cited above contains a very comprehenhive discussion of the evils

vestors (Id. at 308), was the fact that the shares of the fund were offered to the public as a device whereby a small investor could conveniently participate in diversified investments in corporate stocks (Id. at 305).

Relevant to the sections of the Act here relied upon, is the reason or incentive which led to the organization and creation of mutual funds—that is, the compensation or "profit incentive." The organizer of a fund would usually also own or control the corporate "investment advisor" to the fund—this advisor would receive as compensation for its services, a fixed percentage of the value of the portfolio. Also, it was not uncommon for the "organizer" to own or control the corporate "underwriters" which sold the shares of the fund to the public, so that there was also compensation to the "organizer" by way of sales commissions on these sales. Of course, there were also the brokerage commissions to be realized on the sales and purchases of the portfolio securities held by the mutual fund—another valuable item of patronage.

Since it was important to the organizers that these advisory fees, sales commissions, and brokerage fees be awarded by contract or practice to themselves, they were commonly represented in the counsels of the management of the fund (the Investment Company Act refers to them as "affiliated persons"). Thus, as these funds developed, there were contractual relationships involved in the basic operation of the fund which were fraught with self-interest and dealings by "insiders" (or affiliated persons). Abuses arising out of this conflict of interests and interlocking relationships (together with other problems) in 1940 led to the adoption of the Investment Company Act.

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in the mutual fund industry which gave rise to the passage of the Investment Company Act, plus an informative discussion of the Act itself and what it was designed to accomplish. Mr. Alfred Jaretzki was a partner in the law firm of Sullivan and Cromwell in New York. He fully documents his article by reference to Congressional Reports and proceedings.

The Complaints.

The facts set forth in the Complaints are confessed by respondents' motion.

1. **The Parties Defendant.** The following is a list of the defendants:

Individual Slaytons (Hilton & Hovey)	Officers and directors in "working control" of the Fund (R. 14) who also controlled or owned the Slayton Companies (R. 2).
Slayton Companies*	
Slayton & Co., Inc., and Mutual Funds Distributors, Inc.	"Underwriters" which sold the Fund's shares to the public, controlled by the Slaytons.
Slayton Associates, Inc.	The Fund's designated investment adviser, owned by the Slaytons.
Directors (including Respondents)	Twelve former directors, other than the Slaytons, referred to in Fund's complaint as "outside directors" (R. 3).
Model, Roland & Stone	A partnership of eleven New York brokers (R. 3).
Stephen M. Jacquith	Associated with the brokers as investment adviser (R. 14).
Harold W. Smith	Brother-in-law of defendant Hovey Slayton and "employee" of brokers (R. 3).
James S. Stubbs	Former director of Fund, former business associate of the Slaytons and "employee" of brokers (R. 3).

* Slayton Associates, Inc., is hereinafter referred to as "Slayton Associates"; Slayton & Company, Inc. and Mutual Fund Distributors, Inc., are hereinafter referred to, separately as "Slayton & Co." and "Mutual", and jointly as "Slayton Sales Companies."

2. **Resumé of Facts Alleged in the Complaints.**

While the details of the complaints are summarized and analyzed below, it can be stated that the following averments of illegality are common to both complaints:

(a) That the petitioner Managed Funds was operated, by the respondent directors, under an illegal investment advisory contract arranged by the Slaytons, who dominated the operation, with the defendants Jaquith and his employer Model, Roland & Stone (the defendant New York brokerage firm) and that this contract was illegal under Section 15 (a) of the Act because it had never been approved by shareholders as required by that Section (R. 5, 7);

(b) That the official investment advisory contract made by the Fund with the defendants Slayton Associates, Inc., was terminated by abdication of the Slaytons and assignment thereof, which assignment terminated this contract, according to its terms, and as required by the Act; but that nevertheless said employment was continued by "successive written contracts" (R. 15) from year to year, under the management of the directors, in violation of Section 15 (c) of the Act, charging them with responsibility for renewals of such employment.

(c) That after the Fund had declared an official policy of "capital growth," its portfolio was mismanaged by defendants, causing a "deviation" from declared policy made illegal by Section 13 (a) (3), of the Act (R. 4, par. 12; R. 7, par. (c)).

A. **The Fund's unlawful investment advisers and the parties responsible for payments made to said advisers.**

Commencing August 15, 1952, and continuing until April, 1959, the Slaytons' advisory corporation, Slayton

Associates, was awarded successive written contracts to act as the Fund's disclosed investment adviser (R. 4, 15).

This initial advisory contract was approved by the Fund's stockholders as required by Section 15 (a) of the Act, but relevant to the averments in the complaints, this written contract was, after August 15, 1954, extended each year throughout the period (R. 15). Under Section 15 (c) of the Act such contract could only be extended by stockholders or a majority of the "unaffiliated directors." The respondents, as above stated, are all unaffiliated directors designated as "outside directors" in the petitioner's complaint (R. 3).

This advisory contract provided that Slayton Associates would render advisory, research and statistical services with reference to investments as were in accordance with Managed Funds' policies (R. 4). Slayton Associates was paid by the Fund an annual fee in the amount of ½ of 1% of the Fund's asset value (R. 4), and said payments over the period totaled in excess of $1,000,000 (R. 15). This August 15, 1952, contract, effective throughout the period, provided that it was not assignable (R. 15); such a provision was required by the Act, Section 15 (a) (4).

Commencing on December 1, 1953, and continuing until April, 1959, defendant Jaquith (the defendant brokers' investment adviser) assumed the duties of Slayton Associates, the above-mentioned designated investment adviser for Managed Funds (R. 5, 15). Slayton Associates, while still receiving the fee from the Fund as set forth above, for purporting to perform advisory services, unlawfully delegated its duties to Jaquith and the defendant brokers and abdicated its duties and responsibilities under said contract (R. 5). This assignment terminated the contract and rendered the payments illegal.

This assignment and transfer to defendant Jaquith of the advisory functions took the form of a ten-year con-

tract, dated December 1, 1953, wherein defendant Jaquith was employed as investment counsellor and manager of the securities portfolio of the Fund (R. 5) and was to use his best judgment in the selection, purchase and sale of securities for the Fund and was to be compensated in the form of minimum brokerage commissions with respect to the Fund's portfolio transactions directed to Jaquith's firm, the defendant brokers (R. 5, 15).

Neither the said contract of December 1, 1953, between Slayton Associates and Jaquith, nor Jaquith's assumption of the investment advisory function for Slayton Associates thereafter, was ever approved by the stockholders of Managed Funds (R. 7, 16), as required by Section 15 of the Act.

Notwithstanding the assignment by Slayton Associates and the assumption of the advisory function by the defendant brokers and the failure to have this relationship approved by the stockholders, the Slaytons and the directors, including the respondents, caused or permitted (R. 6, 19) the Fund to continue the Slayton Associates contract for five and one-half years and to pay Slayton Associates in excess of $1,000,000 during the period for services that Slayton Associates did not perform (R. 16).

It followed from the termination, by assignment, of the Slayton Associates contract, that Jaquith and the partnership of Model, Roland and Stone "served or acted as investment advisers of the plaintiff without a written contract approved by a vote of majority of the outstanding voting securities of plaintiff" [R. 7, par. 21 (d)].

During this same period, the same defendants caused the Fund to pay the defendant brokers and Jaquith in excess of $1,500,000 in brokerage commissions in payment for investment advice (R. 5, 16).

The complaints allege that such conduct was in violation of the Investment Company Act of 1940 since Slay-

ton Associates unlawfully abdicated its function and defendants Jaquith and the brokers served and acted as investment advisers, without a written contract approved by the stockholders (R. 7). Section 15 (a) provides that it is illegal to act as an investment adviser unless a written contract is approved by the stockholders of the fund. Subsection 15 (a) (4) requires automatic termination of a stockholder-approved advisory contract upon its assignment. Aiding the remedy, both illegal contracts were expressly declared "void" under Section 47 (b), Title 15, U. S. C., Sec. 80a-46 (b).

Managed Funds claimed it was a breach of the directors' duties under the Act [15 (c)] to approve an advisory contract, and make payments thereunder when the designated adviser was rendering no services therefor and when the contract, by the provisions of the Act, had been terminated [15 (a) (4)] and was void [47 (b)]. It was a further breach of the directors' duties, under 15 (a) and (c), to cause Managed Funds to operate, and to pay out money to the defendant brokers, under the unapproved and second illegal and void contract! Not only was it alleged that respondents did this, but it is alleged that they did it "knowingly" (R. 6, 19).

B. **The Fund's unlawful deviation from its stated investment policy and parties responsible therefor.** Part and parcel with the payments made under said unlawful advisory contract were the directors' breach of duty in following an unlawful investment policy, or as the Act calls it, "deviation" from the declared policy—required to be disclosed.

In accordance with the Investment Company Act Section 8 (b) (2), the announced policy of Managed Funds, as set forth in its registration statements and prospectuses, was to provide for "capital growth" and to the extent consistent with such policy, to seek reasonable income on

its investments, which net investment income and any realized profits on the sale of securities in its portfolio would be distributed quarterly (R. 4).

After the defendant Jaquith and the broker defendants usurped the advisory function, the Fund's basic policy of "capital growth" was not followed (R. 5, 6). Rather, a policy was followed in handling the Fund's portfolio so as to maintain a predetermined amount of distributions and, if income from portfolio investment was insufficient, to realize forced capital gains from the sale of the Fund's portfolio securities to pay these distributions (R. 5, 6).

This policy, which respondents followed at the direction of the insiders (R. 6, 19), was a deviation from the stated policy of "capital growth" in that the Fund's portfolio securities were "churned" so that in 1958, as an instance, the rate of turnover of the portfolio securities was 98% as compared with 20% average for mutual funds (R. 16).* This deviation from stated policy was likewise done without stockholder approval (R. 16).

The policy which was followed resulted in gross mismanagement of and loss and damage to the Fund's portfolio (R. 6). The portfolio was thus churned (R. 16) to realize capital gains so as to keep up an appearance of high "dividends", a sales feature exploited by the Slayton Sales Companies, who profited by touting this high return feature of the shares (R. 6).

Section 13 (a) (3) makes it unlawful to deviate from a mutual fund's fundamental policy, stated under 8 (b)

* The S. E. C. in the Managed Funds, stop order proceedings particularized certain of these transactions, and concluded:

> "Registrant's transactions of the type illustrated by the foregoing table obviously served no legitimate purpose and were inconsistent with its stated policy of placing primary emphasis on capital growth." *In re Managed Funds, Inc.*, C. C. H. Federal Security Law Reporter, Current, Par. 76,662, p. 80,510.

(2), unless authorized by a majority of the fund's outstanding securities. The Managed Fund's complaint alleged that the policy followed was thus illegal as being contrary to the Fund's stated policy (R. 7). Further, it was alleged and it is contrary to the policy of the Act, Section 1 (b) (2), for a fund to be operated, managed, and its portfolio securities selected, in the interest of directors, officers, investment advisers, brokers and dealers, rather than in the interest of all classes of security holders (R. 6, 7).

The policy of high turnover of the Fund's portfolio securities resulted in a direct benefit to the defendant brokers and Jaquith (R. 6) who, as above stated, were also doubling as investment advisers and were being compensated in the form of brokerage commissions paid by the Fund on portfolio transactions (R. 5). The more the defendants bought and sold at the advice of these broker-advisers, the more commissions paid the broker-defendants. The $1,500,000 paid said brokers was sufficient to enable them to pay, at the direction of the Slayton defendants, the defendant Smith (Hovey Slayton's brother-in-law), and the defendant Stubbs (the Slaytons' former business associate and former director of the Fund) in excess of $50,000 per year each, in commissions, when said defendant recipients did not perform any services in return for such payments (R. 5).

Petitioner claimed respondent directors had a duty under the Act not to permit and certainly not to participate in causing a deviation from fundamental policy, and that they were jointly liable for this violation and breach of statutory duty; the directors are in charge of the Fund's investment policy; the capital gains which were realized pursuant to the policy actually followed were distributed to stockholders by these respondent directors, who declared dividends; the distribution of these capital gains by re-

spondents was part and parcel of the unlawful policy. These respondents knowingly participated, aided and abetted a plan whereby petitioner was operated in the interest of insiders rather than in the interest of the stockholders (R. 6, 19).

C. Participation and Knowledge of the Respondent "Outside" Directors.

The complaints in both cases charge "the defendants" (which, of course, includes the respondent directors) with violation of the Investment Company Act (R. 1 and R. 13).

The Managed Funds' complaint in Par. 6 (R. 3) refers to the defendant directors by name, including respondents, and calls them "outside directors"—a term now generally used to mean directors who are not officers of, or employed by, the company which they serve as directors. And in the context, the term would also mean "unaffiliated" directors as used in the Act. Here is the allegation as to the knowledge of these outside directors:

> "On information and belief, the said outside directors, and each of them, had either actual knowledge of the acts hereinafter complained of, or, in the performance of the duties and obligations imposed upon them by law as directors, and by the exercise of ordinary care and diligence in the performance of such duties and obligations, would have acquired knowledge of such acts, and hence are chargeable with having constructive knowledge thereof."

The same complaint states in Par. 21 that "the defendants" (including, of course, the respondents) "committed or with actual or constructive knowledge, as hereinbefore set forth, aided, abetted, acquiesced in, or condoned, directly or indirectly, violations of the Investment Company Act of 1940, in that, inter alia," (a) "the plaintiff was

operated, managed, and its portfolio securities were selected" in the interest of insiders; (b) the plaintiff Fund was caused to publish untrue statements; (c) the Fund was caused to deviate from a fundamental policy without authority of its "outstanding voting securities"; (d) the brokers and Jaquith "served or acted as investment advisers of the plaintiff, without a written contract, approved by a vote of majority of the outstanding voting securities of Plaintiff" (R. 6 and R. 7).

Count III of the Managed Funds' complaint re-alleges the basic facts of Count I: the illegal Jaquith contract; the abdication by Slayton Associates; the illegal deviation from declared policy. Then in substance, the Count sets up that the Slaytons and the broker—Model defendants were fiduciaries; the latter were acting as investment advisers (R. 9 and R. 10).

Then the knowledge of defendants is alleged: "and each of the other defendants had actual knowledge of the relationship of defendants Hilton H. Slayton and Hovey E. Slayton to plaintiff, and actual or constructive knowledge of the relationship of said members of the co-partnership of Model, Roland and Stone, and of Stephen M. Jaquith, to plaintiff" (R. 9 and R. 10).

Par. 6 of Count III says that "all of the defendants had actual knowledge of the fact of the relationship of defendants Hilton H. Slayton and Hovey E. Slayton to plaintiff; all of the defendants had actual or constructive knowledge of the relationship of the said defendants" (brokers and Jaquith) and "hence all defendants are chargeable with and liable for the said acts" (R. 10).

3. Relief Sought.

The complaints sought not only an accounting for profits from those defendants who profited, but also sought

damages from all defendants jointly liable, whose illegal acts proximately caused damage to the Fund. The damages claimed against respondents were for their participation in the unlawful payment of over $1,000,000 for "advisory services," which were not rendered, an obvious basis of damage. Secondly, respondents are alleged to be jointly liable for losses to Managed Funds as a result of the illegal investment policy followed. On the accounting aspect of the case (which overlaps the damage claims at least as to the fees paid the advisers), respondents are liable even if it is not alleged that they profited directly, since they knowingly made or permitted such payments to be made and should be jointly liable therefor.

Rulings on Respondents' Motions.

As above stated, Judge Weber overruled respondents' motions to dismiss. On the interlocutory appeal taken by respondents, the Court of Appeals reversed this ruling and ordered respondents dismissed from the cause. In its opinion the Court of Appeals held that there was no legislative intent to impose duties on directors (R. 60), and that the complaints which alleged knowing participation by these respondents asserted only insurers' liability (R. 71).

ARGUMENT.

The Court of Appeals erred in reversing the order of the District Court on the interlocutory appeal and in ordering respondent directors dismissed from the cause. There are duties imposed upon directors under the Investment Company Act and a mutual fund can recover its damages from them resulting from their violation or breach of duty. The complaints alleged a breach of certain statutory duties imposed on respondents and violation of the Act by respondents to the damage of the Fund. The Court of Appeals misconstrued the complaints as asserting insurers' liability, as the complaints alleged knowing participation in the illegal acts alleged and breach of duty by respondents.

SUMMARY OF THE ARGUMENT.

Specific sections of the Act impose duties upon directors, officers, investment advisers of a mutual fund, and Section 44 grants Federal jurisdiction if breach of these duties are alleged. The complaints allege a claim for breach of these duties and violation of the Act by respondents-directors to the damage of the Fund.

It is the intention of Congress to afford private remedies to suitors under the Securities Acts, cognizable in the Federal District Court. This is even more apparent under the Investment Company Act which regulates the internal affairs of mutual funds. Specific sections and the recited purpose and history of the Act strongly support the imposition of duties on directors and provide a private remedy to the Fund and shareholders who were intended to be protected.

The relevant sections of the Act here involved creating statutory duties on directors, are (1) Section 15, regulating the employment of insider, investment advisors and Section 47 (b), making illegal advisory contracts void, and (2) Sections 8 (b) (2) and 13 (a) (3), requiring adherence to stated, fundamental investment policy.

1. The directors under Section 15 are given the express responsibility to have investment advisory contracts approved by stockholders and by that section, it is illegal to perform an unapproved advisory contract. The directors have a duty of supervision under Section 15 and to use due diligence in extending stockholder approved contracts, and in operating the fund—authorizing the payment of money—under such contracts. Supplementing the remedy, Section 47 (b) makes illegal contracts void.

These duties were breached to the damage of the Fund when respondents knowingly approved and paid out monies

under one illegal advisory contract to an insider advisor (Slayton Associates), which was performing no services. The duties of these directors were further breached when, at the same time, the directors failed to submit to stockholders the employment of the actual adviser (the brokers), and knowingly permitted the Fund to operate with and pay money to such advisor (selected by the Slayton's to perform their advisory function) under this unapproved and, hence, illegal and void contract.

2. The directors have a duty, under 13 (a) (3), to require the fund to adhere to its stated fundamental investment policy. When they knowingly participate with insiders to cause the fund to deviate from that policy to the damage of the fund they are liable.

3. The complaints alleged a breach of these statutory duties by respondents to the damage of the Fund. It was alleged that the directors "knowingly" "participated" in specific violations of the Act. These allegations are sufficient to charge respondents themselves with such violations.

Under the rules, a pleader need only state a claim for relief and a complaint should not be dismissed unless it appears beyond doubt that plaintiff can prove no set of facts to support his claim.

Petitioner submits therefore that this Court should reverse the order of the Court of Appeals which dismissed respondents from the cause.

I.

The Investment Company Act of 1940 Imposes Duties on Directors and They Are Subject to Liability to the Mutual Fund for Which They Act, Where They Breach Such Duties or Participate in Violating the Act, Thereby Causing Damage to the Fund.

As above stated this action is grounded upon two primary breaches of duty created by the Act and respondents' participation in violating the Act.

It is necessary to trace the development of statutory liability as a basis for Federal jurisdiction and the cases under other Securities Acts where such questions have arisen in the past. We will then discuss the Investment Company Act and the particular sections here involved, to show that directors have duties under that Act and that respondents breached those duties to the damage of the fund.

The Basis of Statutory Liability Under the Securities Acts.

Other securities acts,* also have provisions giving the Federal Court jurisdiction over suits based upon a breach of statutory duties created by those acts. There have been numerous cases holding that a plaintiff may recover in tort for damages caused by the violation of duty created by one of these acts.**

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* Securities Act of 1933 and Trust Indenture Act of 1939 (Section 77 et seq. of Title 15, U. S. C.); Securities Exchange Act of 1934 (Section 78 et seq. of Title 15, U. S. C. A.); Public Utility Holding Company Act of 1935 (Section 79 et seq. of Title 15, U. S. C.).

** Cases in the Second Circuit: *Baird v. Franklin*, 141 F. 2d 238 (2d Cir., 1944), cert. denied, 323 U. S. 737, 89 L. Ed. 590, 65 S. Ct. 36; *Goldstein v. Groesbeck*, 142 F. 2d 422 (2d Cir., 1944), cert. denied, 323 U. S. 737, 89 L. Ed. 590, 65 S. Ct. 36.

This is the doctrine of implying a remedy for violation of a statute. Louis Loss, Securities Regulations, pp. 1043-1045 (1951), states the bases of such liability:

> "(a) The Bases of Liability.
>
> "The implied liabilities under these statutes rest on two bases. One is the provision of Section 29 (b) of the Exchange Act—substantially repeated in the Holding Company, Investment Company and Investment Advisers Acts—to the effect that every contract made in violation of the statute or any rule thereunder, as well as every contract whose performance will involve such a violation, shall be 'void' as regards the rights of (1) any violator and (2) any person, not a party to the contract, who acquires any right thereunder with actual knowledge of the facts resulting in the violation. • • •
>
> "The other basis of the implied liabilities is the common-law tort doctrine of private action based on violation of a statute. • • • It is all a matter of 'legislative intention.'"

Many of these cases have relied upon the decision of this Court in **Texas & P. R. Co. v. Rigsby**, 241 U. S. 33, 40, 60 L. Ed. 874, 36 S. Ct. 482 (1916), wherein the "inference of a private right of action" for violation of a Federal statute was upheld on the application of the maxim,

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and *Fischman v. Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir., 1951); the Third Circuit: *Slavin v. Germantown Fire Ins. Co.*, 174 F. 2d 799 (3rd Cir., 1949); the Seventh Circuit: *Juneau v. K & D Mining Co.*, 260 F. 2d 607 (7th Cir., 1958); the Ninth Circuit: *Pratt v. Robinson*, 203 F. 2d 627 (9th Cir., 1953), and *Errion v. Connell*, 236 F. 2d 447 (9th Cir., 1956); *Matheson v. Armbrust*, 284 F. 2d 670 (9th Cir., 1960), *cert. denied*, 365 U. S. 870, 5 L. Ed. 2d 860, 81 S. Ct. 904, and recently, by the Fifth Circuit, *Hooper v. Mountain States Securities Corp.*, 282 F. 2d 195 (5th Cir., 1960), *cert. denied*, 365 U. S. 814, 5 L. Ed. 2d 693, 81 S. Ct. 695; and, more recently (since the instant decision), by the Sixth Circuit, *Dann v. Studebaker-Packard Corporation*, 288 F. 2d 201 (6th Cir., 1961).

"Ubi jus ibi remedium". This was a suit by a railroad employee for injury resulting from a violation of the Safety Appliance Act. This Court said (241 U. S. 39):

> "A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied . . ."

Private remedies have been implied even though the same statute provided for other private remedies.* In **A. C. Frost & Co. v. Coeur D'Alene Mines Corp.**, 312 U. S. 38, 43, 85 L. Ed. 500, 61 S. Ct. 414 (1941), this rule was stated as follows:

> "Courts have often added a sanction to those prescribed for an offense created by statute where the circumstances fairly indicated this would further the essential purpose of the enactment; * * *."

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* Likewise, cases construing other securities acts have implied a remedy for breach of duty or violation of the Act under a general jurisdictional section contained in those acts, even though the right of action was not specifically given for the section violated, and an express remedy was provided under other sections of the same statute. See, for example, *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E. D. Pa., 1946), referred to in *Hooper v. Mountain States Securities Corporation, supra*, 282 F. 2d 195 (5th Cir., 1960), *cert. denied*, 365 U. S. 814, 5 L. Ed. 2d 693, 81 S. Ct. 695, as a "trail-blazer". In *Kardon*, the court adopted the rule as announced in Section 286 of the Restatement of the Law of Torts, imposing liability upon one who violates a statute by invading the interest of another, if the intent of the enactment was to protect the interest of the other and the interest invaded was one which the enactment was intended to protect. The court ruled that plaintiff was entitled to recover under Section 78 (j) of the Securities Exchange Act (making the employment of deceptive devices in the purchase of stock unlawful), even though there was no express civil liability for such violation, and this was true in spite of the fact that other sections of the same act did provide civil remedies (e g, Section 78 (p) which prohibited short-swing profits by insiders).

The Corporate Right to Sue:

A corporation has a right of action to recover for breach of duty or violation of a particular section of one of the securities acts when the section involved was intended to protect the corporation.* In **Hooper v. Mountain States Securities Corp.**, supra, 282 F. 2d 195 (5th Cir., 1960), *cert. denied*, 365 U. S. 814, 5 L. Ed. 2d 693, 81 S. Ct. 695, suit was brought on behalf of a bankrupt corporation to recover against defendants, who were insiders, for fraud in the sale and issuance of the corporation's own stock. This stock was issued in exchange for spurious assets transferred to the corporation by one of the defendants in violation of Section 78 (j), Title 15, U. S. C., and Rule X-10B-5 of the Securities Exchange Act, making it unlawful for a purchaser to defraud a seller. The court reversed a dismissal of the complaint and held the corporation was a "person" and entitled to sue; that it was an "investor" entitled to protection under the Act.

That court, on page 201, summed up the remedial character of the Securities Exchange Act as follows:

> "In a substantive way it is even more sweeping. It greatly expands the protection frequently so hemmed in by the traditional concepts of common law misrepresentation and deceit, the requirement of privity, proof of specific damage, inadequacy of the right of rescission or right to recover up to par value of stock of a much greater market value. To these difficulties would have to be added the geographic

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* *Goldstein v. Groesbeck*, 142 F. 2d 422 (2d Cir., 1944); *Stella v. Kaiser*, 82 F. Supp. 301 (S. D. N. Y., 1948); *Slavin v. Germantown Fire Ins. Co.*, 174 F. 2d 799 (3d Cir., 1949); *Collings v. Busch Manufacturing Co.*, 19 F. R. D. 297 (S. D. N. Y., 1956); *Hooper v. Mountain States Securities Corporation*, 282 F. 2d 195 (5th Cir., 1960), *cert. denied*, 365 U. S. 814, 5 L. Ed. 2d 693, 81 S. Ct. 695.

obstacle of suit in a common forum against multi-state defendants scattered as far as the fraudulent device required."

There have been limitations placed upon recovery for violations of such statutes. Naturally, plaintiff must show that it is within the class of persons which the statute contemplated to protect, and some cases have held for that reason (under the facts there involved) that the corporation was not entitled to recover.** Of course, there must be a causal connection between the violation or breach and plaintiff's claim of damage.***

Suits Dealing With Private Claims Under the Investment Company Act:

The Investment Company Act is much more far-reaching than these above mentioned Securities Acts. They are, by and large, disclosure acts. But the Investment Company Act, as Petitioner claims, is a statute regulating the internal affairs of a particular type of business.

Congress, in passing the Investment Company Act, determined that the Securities Act of 1933 and the Securities Exchange Act of 1934 were inadequate to abate or eliminate abuses in investment companies. See Senate Report No. 1775, 76th Congress, 3rd Session, June 6, 1940, where this statement appears on page 11.

A mutual fund, like any public corporation, must comply with the Securities Act of 1933 in the sale of its stock to the public insofar as the registration of its stock and the

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** *Birnbaum v. Newport Steel Corp.*, 193 F. 2d 461 (2d Cir., 1952); *Howard v. Furst*, 238 F. 2d 700 (2d Cir., 1956), *cert. denied*, 353 U. S. 937, 1 L. Ed. 2d 759, 77 S. Ct. 814 (distinguished in *Hooper v. Mountain States Securities Corp.*, 282 F. 2d 195 (5th Cir., 1960), *supra*.

*** *Downing v. Howard*, 162 F. 2d 654 (3rd Cir., 1947).

issuance of prospectuses are concerned. But, the Investment Company Act goes far beyond this. It contains provisions regulating management and regulates the advisory and underwriting contracts of these funds which Congress felt were susceptible to exploitation by insiders.

There have been few cases dealing with the private right to sue for breach of duty created by, or violation of the Investment Company Act, but in all cases to date, except for the instant ruling in the Court of Appeals, it has been recognized that a fund is entitled to sue and none except the decision of the Court of Appeals have held directors are immune from liability under the Act.*

A recent pronouncement of the theory of a fund's remedy and the Federal Court's jurisdiction in such cases is **Taussig v. Wellington Fund, Inc.**, 187 F. Supp. 179, 217 (D. Del., 1960):

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* (1 *Schwartz v. Bozeman*, 156 F. Supp. 361 (S. D. N. Y. 1957, appeal dismissed sub nom *Schwartz v. Eaton*, 264 F. 2d 105 (2d Cir., 1959), directors held subject to suit; (2) the Breswick cases [*Breswick & Co. v. United States*, 134 F. Supp. 132, 138 (S. D. N. Y. 1955); *Breswick & Co. v. Briggs*, 135 F. Supp. 397 (S. D. N. Y., 1955), investment company's claim against directors for "noncompliance with the Investment Company Act" was confirmed (pp. 403, 404); *Breswick & Co. v. United States*, 138 F. Supp. 123, 131 (S. D. N. Y., 1955), reversed on other grounds; *Allegany Corp. v. Breswick & Co.*, 353 U. S. 151, 1 L. Ed. 2d 726, 77 S. Ct. 703 (1957)]; (3) *Cogan v. Johnston*, 162 F. Supp. 907 (S. D. N. Y., 1958), jurisdiction of the court upheld in derivative suit against officers and directors operating an unregistered investment company. On page 909, the court in *Cogan* said:

> "I conclude that jurisdiction is properly invoked under Section 44 of the Investment Company Act, which grants to the district court jurisdiction of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, the Act or the rules, regulations or orders thereunder."

(4) See also, *Taussig v. Wellington Fund, Inc.*, 187 F. Supp. 179 (D. Del., 1960), *infra*. (5) *Brozen v. Bullock*, 194 F. Supp. 207 (S. D. N. Y., 1961), *infra*; (6) *Lutz v. Boas*, 171 A. 2d 381 (Ch. Ct. Del., 1961), *infra*.

"Violation of a federal statute may accord a private litigant a remedy by implication notwithstanding the absence of specific statutory authority conferring upon the injured the right to redress statutory wrongs, for the common law will supply a remedy where the statute is silent. The intention to create civil liability is presumed unless a contrary legislative intent is to be inferred from the whole purview of the Act."

A. **Directors of a mutual fund have a duty, under Section 15 of the Act, to see that advisory contracts, under which they operate, are initially approved by stockholders. Thereafter they have a duty under such Section to supervise the approval and extension of such contracts, and the payment of monies to insider investment advisers. This duty is breached by operating a fund with an unapproved contract or approving or extending contracts after assignment and termination especially with an adviser who renders no service for its fee, and in paying out money under contracts illegal under Section 15 and void under 47 (b). A fund can recover its losses from directors breaching such duties.**

By enacting Section 15, Congress entered the field of regulating insider, investment advisory contracts. The enactment required that such contracts be initially approved by stockholders and be in writing; that it be limited to two years' duration and be annually approved by directors and that the contract contain certain provisions; that the contract specify the compensation to be paid the adviser; that it contain a termination clause upon assignment, and that the contract also contain a 60-day termination clause, exercisable by the directors. The section specifies that after two years from initial approval by the directors and stockholders, the contract may be extended by majority of the board and the **unaffiliated directors** or by the shareholders. It is unlawful to operate without such an approved contract.

Section 15 (a), in full text, provides:

"(a) After one year from the effective date of this subchapter and sections 72 (a) and 107 (f) of Title II it shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, unless in effect prior to March 15, 1940, has been approved by the vote of a majority of the outstanding voting securities of such registered company and—

"(1) precisely describes all compensation to be paid thereunder;

"(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

"(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

"(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser."

Section 15 (c) provides:

"(c) In addition to the requirements of subsections (a) and (b) of this section it shall be unlawful for

any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, except a written agreement which was in effect prior to March 15, 1940, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party, or (2) by the vote of a majority of the outstanding voting securities of such company."

Section 47 (b) [80a-46 (b)] imposes a substantive sanction. It declares:

> "Every contract made in violation of any provision of this subchapter . . . and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this subchapter . . . shall be void . . ."

Such a statutory sanction was given remedial effect to support the claim of a public utility against its holding company and directors in an important case in the Second Circuit, **Goldstein v. Groesbeck**, 142 F. 2d 422 (2d Cir., 1944), cert. denied, 323 U. S. 737, 89 L. Ed. 591, 65 S. Ct. 36. The Court there held the directors of Electric Bond and Share liable for violation of duty in failing to register EBS as required by the Public Utility Holding Company Act. The suit was on behalf of the subsidiary corporation for amounts paid out under a contract with an affiliate (Ebasco) of said unregistered company (EBS). The contract was therefore (by that Act) unlawful and void. That Court, in ruling that the plaintiff stated a claim, said on pages 425 and 426:

"Section 25, U. S. C. A., § 79y [identical to Section 44 of the Investment Company Act], provides that 'any suit or action to enforce any liability or duty created by' the Act may be brought 'in the district wherein any act or transaction constituting the violation occurred' or 'in the district wherein the defendant is an inhabitant or transacts business.' The present action is surely to enforce a duty created by the Act, since but for the Act the payments under the service and construction contracts would be innocuous enough; and the words 'any liability or duty' are clearly broad enough to include any breaches of duty causing injury or loss to private persons."

. . . . . .

"Thus, the statutory declaration of the necessity for control of holding companies in § 1 (b) (2), 15 U. S. C. A., § 79a (b) (2), states, inter alia, that the national public interest is adversely affected 'when subsidiary public utility companies are subjected to excessive charges for services.' The three specific sanctions stated in the Act—injunction, § 18 (f), 15 U. S. C. A., § 79r (f); criminal punishment, § 29, 15 U. S. C. A., § 79z-3; and the negative relief of § 26 (b), declaring the contracts void—do not in terms place the defrauded operating company in statu quo; and § 26 is incomplete, if not ineffective, unless it is considered to authorize recovery by the operating companies."

The above cited section of the Public Utility Holding Company Act [§ 26 (b)], making illegal contracts void, is identical to Section 47 (b) of the Investment Company Act of 1940.

The Investment Company Act, like the Public Utility Holding Company Act, is much more than a disclosure act. It is a Federal Corporation Code, superimposed on state law, regulating the internal affairs of every corporation engaged in the mutual fund business.

There has been a recent case decided by Judge Herlands, of the Southern District of New York, since the ruling of the Court of Appeals, which has eloquently announced the Fund's position, that directors of a mutual fund have duties under Section 15 of the Act regarding the extension of, and payment of monies under insider advisory contracts. **Brown v. Bullock**, 194 F. Supp. 207 (S. D. N. Y., 1961). (The Second Circuit has permitted an interlocutory appeal, which has been argued and is pending.)

This case was a stockholder's suit on behalf of the Bullock fund (called Dividend Shares, Inc.) against the officers, directors and investment adviser to repay excessive advisory fees to the fund. There, as in this case, the complaint alleged that the directors were under the dominion of the insiders and blindly approved the contract with the adviser controlled by such insiders. However, in **Bullock** there were no allegations, as here, that there were **no** services being performed under the advisory contracts, but only that the amounts paid were excessive. Although in **Bullock** the directors' authority to approve these contracts was questioned, there was no claim, as here, that the advisory contracts were illegal or void. Nor was there a claim, there, of a deviation from stated investment policy by the directors there sued.

The District Court in **Bullock**, in a comprehensive opinion, ruled that the complaint stated a claim and that the court had jurisdiction under the Act. The court, on page 235, held that the directors of a fund have duties under Section 15 of the Act:

> "The directors are thus charged by the Act with critically important powers and duties of a specific nature. Each year they must pass upon the extension of the investment advisory contract, unless they refer the decision to the stockholders; they (the directors)

have the authority to terminate the contract 'at any time' on sixty days' notice; and, when the contract is made or is to be renewed, there must be a majority of the disinterested directors.

"**The grant of these defined powers, as specified by the Act, carries with it the imposition of corresponding duties. The power to extend the investment advisory contract necessarily carries with it the duty to determine whether or not the extension is desirable and in the best interest of the company. The power to terminate the investment advisory contract necessarily carries with it the duty to keep alert for reasons which might make termination necessary or desirable**; and, in the presence of such reasons, to exercise the right of termination. The objectives of the Act would be nullified if the directors were free to extend mechanically the contract without honestly exercising their best judgment. The objectives of the Act would be equally frustrated if the directors were free to close their eyes to any developments making the termination of the contract advisable.

"By giving the directors the right to extend and to terminate the contract, the Act necessarily also imposes upon the directors the fiduciary duty to use these powers intelligently, diligently and solely for the interests of the company and its stockholders. These specific fiduciary duties are created by the Act. Their violation subjects the directors to liability, which can be enforced in the federal courts under section 44 of the Act." (Emphasis supplied.)

What duties did respondents have regarding these two contracts? (1) the contract with Slayton Associates which was initially approved and then extended throughout the period; (2) the contract with Jaquith and the brokers which was never approved. First, the Slayton Associates contract.

1. Section 15 (a) provides that an advisory contract is in effect "only so long as such continuance is specifically approved at least annually by the board of directors." Section 15 (c) makes it ultra vires and illegal for a fund which has a board of directors to "renew" or "perform" any advisory contract without approval of a majority of the unaffiliated ("outside") directors. These sections impose duties (as to specific contracts of the corporation) of vigilance and due care on directors in making such extensions, and certainly the directors cannot knowingly extend and pay money to an adviser (i. e. "perform") when the adviser's contract has been unlawfully assigned and the insider performs no services for the payments.

Section 15 (a) imposes a specific statutory duty on all directors, the managers of the Fund, with respect to extending advisory contracts initially approved by the stockholders. The Act authorizes the stockholders to extend these contracts, but if the directors take on this statutory function, as they are empowered to do under Section 15 (c), they must exercise due care. This approval by them is the hallmark of legality. Directors do not discharge their function by approving an advisory contract which gives insiders a license to abstract monies from the Fund.

The directors have the power to terminate such a contract. They have a correlative duty of vigilance to see to it that the adviser being paid is performing. They have a duty not to knowingly pay an adviser who has abdicated to another, thereby, by the adviser's own act, automatically terminating the contract [15 (a) (4)], and making it and the relationship void under 47 (b).

Not only do the provisions of the Act relied upon impose duties upon the entire board of directors, but Subsection 15 (c) imposes a specific power and duty on "un-

affiliated" directors regarding the performance and renewal of advisory contracts. That section provides that it is "unlawful" for advisory contracts to be renewed or performed "unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party, . . .". The subsequent phrase, also conferring such power on the shareholders is not in derogation of the power of the unaffiliated directors.

This section manifestly places supervisory duties upon those members of the board who are not affiliated with the adviser, to prevent the latter from making its own self-dealing, inside contracts. The statute contemplates that the unaffiliated directors are to be the "watch-dogs" for the shareholders in approving or disapproving (not rubber stamping) advisory contracts. These directors certainly have the duty not to extend knowingly, renew or pay out monies (perform) under a contract where the adviser-contractor is not doing the work and the contract is terminated by assignment under Section 15 (a) (4), and the relationship is therefore void under the Act, 47 (b).

Next, the unapproved Jaquith contract.

2. **Section 15 (a) makes it illegal under any circumstances to initially employ an adviser unless such contract is initially approved by shareholders. The directors have a duty under 15 (a) and 15 (c), to require the employment of the actual adviser to be submitted to stockholders for their approval or disapproval. They have a corresponding duty not to perform, pay out money, under such an unapproved contract.**

The Jaquith contract was made by the inside directors through their alter-ego, Slayton Associates. It was per-

formed for five and one-half years without any approval of shareholders. Under the definitions of the Act, Section 2 (a) (19), Jaquith and the defendant brokers were in fact the Fund's adviser. The directors have a duty to require submission of such an advisory contract to the shareholders.

Section 15 thus added to every investment company charter a new *ultra vires* clause concerning the requisite approval of advisory contracts.

Congress by this Act recognized and recited that there then existed a conflict of interest in the inside relationship of investment advisers to these companies—and that advisers were frequently represented on the Board of Directors. Congress did not outlaw this conflict of interest; but neither did Congress leave the investor to proof that such illegal contracts (voidable at common law) actually damaged the Fund. Congress—recognizing such self-interested dealing—provided that the advisory contracts should be disclosed and approved by shareholders, subject always to short-term renewal, or cancellation by the Board itself—with a particular responsibility, upon the disinterested directors, for renewal. The penalty for failure to follow the statutory procedure made the contract illegal and void without more.

How can it be said that liability, based upon violation of the statutory command, does not fall upon the Board of Directors. The function of investment advice was at the very center of the management function: The management of the Fund is the function of the Board and the adviser is **their** adviser. They knew the command of the statute, requiring approval of stockholders for any adviser which they accepted. Can the Board be heard to say that they did not inquire whether their own adviser was legally qualified—despite routine and necessary contacts? It should rather be held that a cause of action is

stated by the mere averment that an investment adviser was employed, and that his employment was not authorized in the manner required by the statute.

But these complaints state that these directors actually knew the relationship of the Slaytons and Jaquith and Model to the Fund (R. 10). These complaints state further that in the ordinary discharge of their duties they knew or should have known of these violations of law (R. 3). If directors knowingly permit violations of these prohibitions or exceed their powers, as defined by this statute, they are liable for losses or damages resulting from such unlawful and void advisory contracts.

If directors know that advisory contracts of this kind must be approved by shareholders and that the shareholders have not approved such contracts, they are exceeding their statutory powers and thereby violating the duty imposed upon them by statute (not by common law) when they knowingly operate with such an adviser. The unapproved advisory contract was not only illegal, but void under the Act [Section 47 (b)]; the directors have a statutory duty not to pay out money under such a contract, knowing it is not approved and, hence, illegal under the Act.

Unquestionably, directors have specific duties under Section 15 in submitting for approval, extending and performing investment advisory contracts. Yet the Court of Appeals, in its opinion, fails to discuss Section 15. The duties, and respondents' breaches thereof, appear even more apparent in this extreme case, which involves many more abuses and more obvious loss than the single claim of excessiveness which was held a sufficient breach of duty in **Bullock**.

But, directors also have duties regarding a fund's investment policy, the second important aspect of this case which the Court of Appeals failed to discuss.

B. The directors of a mutual fund have a duty to require adherence by the fund to its fundamental investment policy, stated pursuant to Section 8 (b) (2). Directors who are charged with the fund's management are liable for losses when they participate with insiders in causing a deviation from such policy contrary to Section 13 (a) (3).

The complaints cite another substantive regulation of the management of investment companies—manifestly aimed at management by the board of directors—requiring declaration by the management of investment policies which were deemed fundamental [Section 8 (b) (2)], and making it illegal to deviate from such policy without approval of shareholders [Section 13 (a) (3)].

Section 8 (b) (2) provides:

> "(b) Every registered investment company shall file with the Commission, within such reasonable time after registration as the Commission shall fix by rules and regulations, an original and such copies of a registration statement, in such form and containing such of the following information and documents as the Commission shall by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors:
>
> "(2) a recital of the policy of the registrant in respect of matters, not enumerated in paragraph (1) of this subsection, which the registrant deems matters of fundamental policy and elects to treat as such;"

Section 13 (a) (3) provides:

> "(a) No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities—
>
> . . .
>
> "(3) deviate from its policy in respect of concentration of investments in any particular industry or

group of industries as recited in its registration statement, or deviate from any fundamental policy recited in its registration statement pursuant to section 80a-8 (b) (2) of this title;"

These sections which require adherence to stated policy are also new, substantive Federal regulations of such corporations. Fundamental investment policy is the function of the Board of Directors. The directors have a statutory duty to prevent, or certainly not to cause or participate in causing, a deviation from stated investment policy. The prohibition of the statute against fundamental change in the nature of the investment policy is not a mere common law prohibition. Violation was a breach of a statutory duty.

Since filing this petition for certiorari, a relevant decision was handed down by Chancellor Seitz in the Chancery Court of New Castle County, Delaware, **Lutz v. Boas**, 171 A. 2d 381 (Ch. Ct., Del., 1961). This decision was rendered in a companion case involving the very same facts as here alleged. That case was originally a derivative suit in which Managed Funds joined as plaintiff, after respondents challenged jurisdiction of the United States District Court in Missouri.

Illustrating the importance of Federal jurisdiction, none of the directors were found in Delaware and the only two who were there joined were served by sequestration of their stock in the Fund.*

The Delaware Court held in this case, on the merits, that Jaquith and the brokers, defendants in the instant case, were illegal investment advisers under the Investment Company Act, as here alleged, and that there was, among

* Only respondent Rice appeared following sequestration of his stock. Respondent Relstock's stock was also sequestered, but he did not appear.

other wrongs, a violation of the Federal Act because of a deviation from the Fund's policy of capital growth by all the defendants and by the directors who managed the Fund. This deviation caused the Fund damage by "losses incurred because of violation of Funds' investment policy." (171 A. 2d 395.) The Court goes on to conclude that the two directors there before the Court were liable for this deviation from stated policy:

> "I am satisfied that these directors are liable because I think it is clear that had they discharged their responsibilities as to general supervision they would have discovered these violations of the Funds' investment policy" (171 A. 2d 396).

This deviation from stated policy is made illegal by the Investment Company Act, Section 13, not the common law.

A deviation is *per se* or presumptively improper and all parties participating,—especially the managing board, particularly if they do so knowingly, should be held liable to the fund for its losses. Without discussing the respondents' duty and manifest responsibility for the deviation from policy, the Court of Appeals referred to *per se* liability (R. 60). The Court mentions this concept in the same breath with its conclusion that the complaints asserted insurers' liability (R. 71). Apparently the Court conceived that petitioner was claiming that, because the corporation violated the statute, the directors were *ipso facto* "per se" liable, whether or not the directors participated in the violation by virtue of their office or status, as if there were no averments of knowing violation: The Court seemed to interpret the averments of the complaints as an assertion of vicarious liability on the managers as though the duty belonged to someone else to manage the Company.

This is not now, nor has it ever been, petitioner's theory. We did say that respondents were liable if their conduct directly or indirectly caused the Fund to violate the Act. We have always claimed these directors' liability rested on breaches of their **own** duty, not someone else's. The fact that others were more active joint tortfeasors, who directly profited, does not exculpate these respondents for their breaches of duty which concurred in causing loss to the Fund.

The Sections of the Act prohibiting a deviation from policy create a statutory limitation on management. We submit that there must be a substantial departure to be a deviation and there must be losses resulting therefrom for the conduct to be actionable. **Lutz v. Boas**, supra, shows how such substantial losses may be proved in this very case, from such illegal deviation, namely, sales contrary to the "capital growth" policy, and immediate repurchase at higher prices -a plain loss to the Fund. If advisers, officers or directors, whomever they be, knowingly cause, or participate in the deviation and cause this loss, they breach a statutory duty over which the Federal court will take jurisdiction.

C. Directors who knowingly cause their corporation to violate the Act breach duties created thereby. Furthermore, directors who aid or abet a fund in violating the Act are themselves in violation of the statute.

The Court of Appeals noted (R. 68) that, "there is a sense in which it can be said, as appellees (petitioner here) have argued, that directors control the various corporate actions of management on policy", but concluded that the provision defining "control" somehow excluded directors' liability in this case. The Court was concerned with liability of directors by mere virtue of their holding office and ignored completely the allegations in the complaints

that the defendants (including respondent directors) knowingly breached statutory duties, and participated in, and aided and abetted in causing the violations of the Act (R. 6).

Not only does the Act impose specific duties on directors, but they have recognized duties of management of a fund. Certainly it is a breach of these duties to participate in causing the fund to violate the Act. Directors cannot excuse their conduct in knowingly causing a fund to violate the Act by saying that the corporation violated the Act and that they are not responsible or that they are not themselves in violation.

In **Thompson v. Greeley**, 107 Mo. 577, 17 S. W. 962 (1891), the directors of a savings bank made excessive loans in violation of the state banking statute. The statute there imposed no penalty or liability on either the "corporation or its directors for the violation of its provisions" (p. 591), and the prohibition in the statute was directed against the corporation only—the statute providing, "no corporation . . . shall loan its money" (p. 591), in excess of certain amounts designated in the statute. The court noted that there was no allegation of bad faith or negligence on the part of the directors—the action was for the violation of statutory duty. The court adopted the view that the directors causing the corporation to violate the statute breached their duties to the corporation and were liable for resulting losses:

> "But every violation of law is a breach of duty . . . Whether that duty required good faith and honesty in the administration of the affairs and business of the corporation as is imposed at common law, or whether it was a duty enjoined or an act prohibited by statute could make no difference so far as doing or omitting them might affect their liability . . . The statute fixed the authority of the directors, in

> respect to the amount in which any person, firm or corporation might become indebted to the bank, and if they wilfully and knowingly permitted the Anchor Milling Company to become indebted to it to a greater amount than was authorized by the statute, and loss to the bank resulted therefrom, they are, and in right should be, liable for such losses . . . The wilful violation of the statute, and consequent loss therefrom furnish sufficient proof of liability" (p. 592).

Also, in **Broderick v. Marcus**, 152 Misc. 413, 272 N. Y. Supp. 455 (Sup. Ct., 1934), an action was brought on behalf of a bank against its former directors for losses arising out of unsecured loans made to an affiliate, which was trading in the bank's shares, in violation of banking laws. As to the basis of the liability of the directors, the court said, 272 N. Y. Supp. 458:

> "The action against the directors involves their accountability from a double aspect: First, that the loans were improvident in that they were made upon no security to corporations without substantial assets; and, second, and more important, that in making the loans which have resulted in the losses referred to the directors violated the banking laws, and the consequences of such violation are the losses of millions of dollars to the bank and its creditors."

The violation of the banking laws referred to placed certain prohibitions on **the bank.** There was no direct statutory prohibition placed on the directors, but the prohibitions contained in the law were mandates to directors. Relying on the case of **People v. Knapp**, 206 N. Y. 373, 99 N. E. 841 (1912), the court held, 272 N. Y. Supp. 460:

> "Consequently the violations of Section 108 in which the directors knowingly participate makes

them severally accountable for damages which such participation occasions."

The **Knapp** case was a criminal action brought against a director of a corporation for violation of the banking laws. The penal statute provided that, 99 N. E. 843:

> "Every director . . . who: . . . (2) wilfully does any act as such director which is expressly forbidden by law, or willfully omits to perform any duty imposed upon him as such director by law, is guilty of a misdemeanor."

It is quite evident that before there could be a conviction under this statute, there had to be an act which the director was "expressly forbidden" to do by law, or which constituted a violation of a "duty" imposed by law,—one of the same issues presented in this proceeding.

The Court of Appeals of New York held counts of an indictment sufficient under this penal section even though the banking section allegedly violated placed restrictions only on **banks** as to the manner of lending money, and there was no **direct statutory prohibition against the directors.**

> "As to the remaining counts the defendant insists that the command that a corporation shall not do a certain act is not a command that the directors shall not do the act. A corporation, however, is a mere conception of the legislative mind. It exists only on paper through the command of the Legislature that its mental conception shall be clothed with power. All its power resides in the directors. Inanimate and incapable of thought, action, or neglect, it cannot hear or obey the voice of the Legislature except through its directors. It can neither act nor omit to act except through them. **Hence a command addressed to a corporation would be idle and vain**

unless the Legislature in directing the corporate body, acting wholly by its directors, to do a thing required or not to do a thing prohibited, meant that the directors should not make or cause the corporation to do what was forbidden, or omit to do what was directed. We think, as the Appellate Division held, that when the corporation itself is forbidden to do an act, the prohibition extends to the board of directors and to each director, separately and individually" (99 N. E. 844).

In addition an officer or director who aids and abets a corporation in violating the law is a principal and is likewise a statute violator. Section 2 (a) of Title 18 U. S. C. provides:

> "Whoever commits an offense against the United States, or aids, abets, counsels, commands, induces or procures its commission, is a principal."

It is the rule that one who causes a corporation to commit a crime may likewise be adjudged in violation. The court in **Wood v. United States**, 204 Fed. 55, 58 (4th Cir., 1913), stated the rule as follows:

> "A corporation can only act through human agencies. If the persons who actually direct and commit the frauds upon the government are not distillers or persons having superintendence of a still, as charged in the counts of the indictment under consideration, no one can ever be in those cases in which the distillery belongs to and is operated by a corporation. Speaking with precise technical accuracy, it may be said that what happened was that the corporation committed these offenses and that the defendants and each of them knowingly, willfully, and actively aided, abetted, and procured their commission."

In **Carolene Products Co. v. United States,** 140 F. 2d 61 (4th Cir., 1944), the corporation and certain officers were convicted for violation of the Filled Milk Act, 21 U. S. C., Section 61, et seq. In this case, the Government admitted that there was no evidence in the record to show that the individual defendants personally made, or even had any personal knowledge of, the eight shipments set out in the indictment. Judge Dobie in affirming the conviction held these officers who were charged with management were responsible for the unlawful act of the corporation.

This Court, in **United States v. Dotterweich,** 320 U. S. 277, 88 L. Ed. 48, 64 S. Ct. 134 (1943), upheld a conviction of corporate officers for violation of the Food and Drug Act (Section 301 et seq., Title 21, U. S. C.) by their corporation, which had been acquitted by the trial court.

This court reversed a decision by the Court of Appeals and reinstated the conviction of the officers, the acquittal of the corporation illustrating the reality that the "only way in which a corporation can act is through individuals who act on its behalf" (320 U. S. 281). Mr. Justice Frankfurter concluded that it was the Congressional intent to put responsibility on corporate managers, and said, p. 283:

> "It is not credible that Congress should by implication have exonerated what is probably a preponderant number of persons involved in acts of disobedience—for the number of non-corporate proprietors is relatively small. Congress, of course, could reverse the process and hold only the corporation and allow its agents to escape. In very exceptional circumstances it may have required this result. See Sherman v. United States, 282 U. S. 25, 75 L. ed. 143, 51 S. Ct. 41. But the history of the present Act, its purposes, its terms, and extended practical construction lead away

from such a result once 'we free our minds from the notion that criminal statutes must be construed by some artificial and conventional rule.' United States v. Union Supply Co., 215 U. S. 50, 55, 54 L. ed. 87, 88, 30 S. Ct. 15."

The Court went on to say, on p. 284:

"The Circuit Court of Appeals was evidently tempted to make such a devitalizing use of the guaranty provision (exonerating a purchaser receiving same) through fear that an enforcement of § 301 (a) as written might operate too harshly by sweeping within its condemnation any person however remotely entangled in the proscribed shipment. But that is not the way to read legislation. Literalism and evisceration are equally to be avoided. **To speak with technical accuracy, under § 301 a corporation may commit an offense and all persons who aid and abet its commission are equally guilty. Whether an accused shares responsibility in the business process resulting in unlawful distribution depends on the evidence produced at the trial and its submission—assuming the evidence warrants it—to the jury under appropriate guidance.**"

The application of the above cited aider and abettor statute (Section 2 of Title 18, U. S. C.), is not limited to criminal proceedings, but has been applied to civil cases under the Securities Acts, see Louis Loss, Securities Regulations, p. 846, Fn. 119.

On the aspect of "causing" a violation, we cited below **R. H. Johnson & Co. v. S. E. C.**, 198 F. 2d 690 (2d Cir., 1952). This case, although it does not deal with directors' liability, does hold persons who fail to supervise or carry out their duty are responsible for "causing" violation of the Securities Acts.

The Investment Company Act does have a procuring violation section, Section 48 (a), 80a-47 (a) of Title 15, U. S. C., making it unlawful for any person to cause, directly or indirectly, a violation. A like section under the Public Utility Holding Company Act (Section 79z-1a of Title 15, U. S. C.) was cited in **Goldstein v. Groesbeck, supra,** 142 F. 2d 422, 426 (2d Cir., 1944), as a basis for sustaining the complaint.

The Investment Company Act of 1940 imposes duties on directors and they are liable to a fund for resulting damage from their breach of such duty or their participation in violation of the Act.

D. **The entire Investment Company Act, its purposes and legislative history, indicate a clear legislative intent to impose duties on directors to protect a fund and its investors from conflicts of interest in management.**

The purposes and declaration of policy are found in Section 1 (b) of the Act, wherein it is provided:

> "the interest of investors is adversely affected—
>
> "(1) when investors purchase, . . . without adequate, accurate, and explicit information, fairly presented, concerning the . . . policies . . . of such companies and their management;
>
> "(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, . . . in the interest of underwriters, brokers, or dealers, . . . rather than in the interest of all class of such companies' security holders;
>
> . . .
>
> "(4) . . . when investment companies are managed by irresponsible persons;
>
> . . .

"(6) when investment companies . . . change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders;"

The Court of Appeals in its efforts to determine legislative intent does not mention these declared purposes of the Act. We submit its decision has frustrated the legislative purpose. Other courts have implemented such statutory purposes as an additional reason for implying a remedy, **Goldstein v. Groesbeck, supra**, 142 F. 2d 422, 426 (2d Cir., 1944).

In **Aldred Inv. Trust v. S. E. C.**, 151 F. 2d 254, 260 (1st Cir., 1945), cert. denied, 326 U. S. 795, 90 L. Ed. 483, 66 S. Ct. 486, the court said:

"§ 1 (b) of the Act, 15 U. S. C. A., § 80a-1 (b), in effect codifies the fiduciary obligations placed upon officers and directors of investment companies."

These statutory fiduciary duties have been recognized. **Breswick & Co. v. United States**, *supra*, 134 F. Supp. 132 (S. D. N. Y., 1955), 138 F. Supp. 123 (S. D. N. Y., 1955), reversed on other grounds: **Alleghany Corp. v. Breswick & Co.**, 353 U. S. 151, 1 L. Ed. 2d 726, 77 S. Ct. 763 (1957):

"One of the purposes of the Investment Company Act is thus to protect investors in investment companies against the managing of those companies in the interests of persons other than the investors." (134 F. Supp. at 138.)

It has also been significantly noted that in construing this Act, Congress gave a directive of broad construction to the courts. Again, in **Brown v. Bullock**, *supra*, 194 F. Supp. 207 (S. D. N. Y., 1961), page 218, the court said:

"Congress built into **the statute a canon of construction.** This is set forth in the concluding sentence of section 1, as follows:

> "'It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors.'

"This is more than a mere exordium. It is a directive to the courts.

"Section 1, entitled 'Findings and Declaration of Policy,' finds 'that the investment companies are affected with a national public interest' in the light of five enumerated factors, recited in subsection '(a).' The fifth of such factors, referring to the inadequacy of 'State regulation,' reads as follows (emphasis supplied):

> "'(5) the activities of such companies, extending over many States, their use of the instrumentalities of interstate commerce and the wide geographic distribution of their security holders, **make difficult, if not impossible, effective State regulation of such companies in the interest of investors.**'" (Emphasis added.)

This was a reality which made it necessary to give suitors a Federal forum with long-arm service of process.

The Act specifically entered the field of director responsibility. Section 9 relates to the eligibility of directors. Section 10 limits directors, affiliated with an adviser, to 60% of the Board. At the hearings in the Congress when this bill was passed, a representative of the

Securities and Exchange Commission stated that the requirement of 40% independent directors "is one of the most salutary provisions of this bill." (Hearings before the Sub-committee of the House Committee on Interstate and Foreign Commerce, H. R. 10065, 75th Congress, 3rd Sess., at 109 [1940].)

Section 10 ties in directly with Section 15 and is the compromise referred to by the Court of Appeals (R. 60), in drafting and enacting said law. There were those who wanted to outlaw self-dealing contracts entirely. The Congress compromised for the sake of reality and the result was Section 15 and, in particular, Section 15 (c), requiring insider contracts to be renewed by vote of the unaffiliated directors. Jaretzki, "The Investment Company Act of 1940", supra, 26 W. U. L. Q. 303 (1941). Congress did not intend that the duties imposed on directors under Section 15 would be discharged by a rubber stamp to the benefit of insiders.

Other sections of the Act show the legislative intent to impose statutory duties upon directors: Section 17 (h) prohibits exculpatory provisions in articles of incorporation, etc., as to the liability of directors. Even where directors do not violate specific statutory duties, as in this case, Section 36 prohibits their gross misconduct or gross abuse of trust. Section 33 (a) requires the fund to report to the S. E. C. settlement of suits against directors for breach of their "official duty."

In the hearings on the bill, the abuses referred to in the purposes sections were detailed.

In the Report of the Hearings of the bill before the Subcommittee on Interstate and Foreign Commerce (75th Congress, 3rd Session, on H. R. 10065, June 13 and 14,

1940), Mr. Schenker summarized the purposes of the bill regarding investment policy:

> "A major problem in the case of management companies is created by the absence of any legal requirement for adherence to any announced investment policies or purposes. Such policies have often been radically changed without the knowledge or prior consent of stockholders. Similarly, after investors have invested in companies on their faith in the reputations and standing of the existing managements, control of the public's funds has frequently been transferred without the prior knowledge or consent of stockholders to other persons who were subsequently guilty of gross mismanagement."

The special significance of Section 44: The jurisdictional section itself is far-reaching in its purpose. It provides concurrent jurisdiction in the state as well as Federal court for actions at law or in equity for violation or breach of duty created by the Act. The Commission can sue only in the Federal court (Section 36) so that Congress must have intended a private remedy in either the Federal or state courts with the procedural advantages afforded a suitor by the long-arm service of process provision set forth in Section 44, if plaintiff selected the Federal forum.

In **Remar v. Clayton Securities Corp.**, 81 F. Supp. 1014 (D. Mass., 1949), Judge Wyzanski in construing Section 27 of the Securities Exchange Act, likewise giving the Federal court jurisdiction over "suits in equity and actions at law to enforce any liability or duty created by" that Act, said:

> "To be sure, the statute created the liability by implication, not by express words. But once the liability was created, its extent was to be measured by * * *

federal rather than a state common law (citations omitted). Suits to enforce a liability having such federal ancestry should be granted credentials of legitimacy in connection with this jurisdictional section of the statute."

There are duties imposed on directors under the Act and a fund can recover for its damage caused by a breach of said duties or violation of the Act.

II.

The Complaints Allege Breaches of These Duties, and Violations of the Act by Respondents to the Damage of the Fund.

The Complaints State Claims Under the Federal Statute. On a motion such as respondents', attacking jurisdiction, the rule is that the court should decide the case on the issue of whether plaintiff states a claim based upon the Constitution or Federal statute sued on, and such a complaint is sufficient unless the Federal question is "wholly unsubstantial or frivolous." **Bell v. Hood,** 327 U. S. 678, 90 L. Ed. 939, 66 S. Ct. 773 (1945). In reversing a dismissal for want of jurisdiction, this Court at 327 U. S. 681 said:

> "Whether or not the complaint as drafted states a common law action in trespass made actionable by state law, it is clear from the way it was drawn that petitioners (plaintiffs) seek recovery squarely on the grounds that respondents violated the Fourth and Fifth Amendments. * * * It cannot be doubted therefore that it was the pleaders' purpose to make violation of these constitutional provisions the basis of this suit. Before deciding that there is no jurisdiction, the

district court must look to the way the complaint is drawn to see if it is drawn so as to claim a right to recover under the Constitution and laws of the United States. For to that extent, 'the party who brings a suit is master to decide what law he will rely upon and . . . does determine whether he will bring a 'suit arising under' the . . . (Constitution or laws) of the United States by his declaration or bill.' "

Mr. Justice Black continued (pp. 681-682):

"(W)here the complaint, as here, is so drawn as to seek recovery directly under the Constitution or laws of the United States, the federal court, but for two possible exceptions later noted, must entertain the suit. * * *

"The previously carved out exceptions are that a suit may sometimes be dismissed for want of jurisdiction where the alleged claim under the Constitution or federal statutes clearly appears to be immaterial and made solely for the purpose of obtaining jurisdiction or where such a claim is wholly insubstantial and frivolous."

Without discussing the content of the complaints or the liberal rules afforded a pleader in resisting a motion such as respondents', the Court of Appeals has followed to the letter respondents' version of petitioner's complaints, that it is "insurers' liability". But, " 'the party who brings a suit is master to decide what law he will rely upon.' " **Bell v. Hood**, supra, 681, quoting from **The Fair v. Kohler Die & Specialty Co.**, 228 U. S. 22, 57 L. Ed. 16, 33 S. Ct. 410 (1913).

We have contended all along that it is not insurers' liability (liability without fault) which the Fund seeks to impose on respondents. These directors were en-

dowed with specific powers over, and obligated by the Act to control particular self-dealing arrangements. This was **their** duty. The complaints allege that the directors knowingly participated, aided and abetted the insiders to violate the Act (R. 6, 19). **They** breached **their** own duties created by the Act.

We have set out above the averments of the complaints as to the "Participation and Knowledge of the Respondents 'Outside' Directors" in violating the Act and the duties imposed upon them.

While advanced as a reason for the derivative suit, here is what the **Josephson** complaint alleged (R. 19):

> ". . . that the directors of MF have approved, acquiesced in, ratified, committed and are committing the very wrongful, willful and illegal acts complained of herein, and the said directors are serving with the approval of, domination and control of the Slaytons and are beholden and completely subservient to their wishes, direction and control . . ."

The Fund's own complaint (R. 6) had a stronger allegation applicable to all defendants, which certainly did not exclude respondents:

> ". . . that the defendants committed, or with actual or constructive knowledge, as hereinabove set forth, aided, abetted, acquiesced in or condoned, directly or indirectly, violations of the Investment Company Act of 1940, . . ." (there follows the allegations relating to the statutory violations).

This is not insurers' liability, and we are not required to label respondents as "conspirators" as the Court of Appeals seems to imply (R. 70).

The Court of Appeals (R. 71) refers to the directors' liability for negligence. Of course, an action under Federal statute cannot be denied merely because the same conduct may afford a basis for action at common law. In **Osborn v. Bank of the United States**, 22 U. S. (9 Wheat.) 738, 818, 6 L. Ed. 204, 223 (1824), Chief Justice Marshall stated:

> "The suit of the **Bank of the United States v. Osborn et al.**, is a case, and the question is, whether it arises under a law of the United States?
>
> "The appellants contend that it does not, because several questions may arise in it, which depend on the general principles of the law, not on any act of Congress.
>
> "If this were sufficient to withdraw a case from the jurisdiction of the federal courts, almost every case, although involving the construction of a law, would be withdrawn; and a clause in the constitution, relating to a subject of vital importance to the government, and expressed in the most comprehensive terms, would be construed to mean almost nothing."

In fact, as above stated, a state chancellor has recently held two out of seven of the appellant directors to be liable in a companion case. **Lutz v. Boas**, 171 A. 2d 381 (Ch. Ct. Del., 1961). The ruling is relevant, because the decision rests upon the Federal Act, as well as upon general equitable principles.

In **Matheson v. Armbrust**, supra, 284 F. 2d 670 (9th Cir., 1960), the court held that the Securities Exchange Act gave the plaintiff an additional, Federal action. On pages 673, 674, the court said:

> "Actions brought to enforce any liability or duty created by section 10 (b) and rule X-10B-5 are therefore additional to state and any other federal actions.

Appellee, as plaintiff, may have had a choice between suing in state or federal court to recover damages for the fraud which appellant perpetrated. If so, the long-established principle is applicable, that 'the party who brings a suit is master to decide what law he will rely upon.' The Fair v. Kohler Die & Specialty Co., 228 U. S. 22, 25, 33 S. Ct. 410, 411, 57 L. Ed. 716.

"We therefore hold that the fact that appellee may have had an adequate civil remedy in the courts of Oregon did not deprive the district court of jurisdiction over the subject matter of this cause of action."

Rule 8 (a). Petitioner need only state a claim under Rule 8 (a) of the Federal Rules of Civil Procedure. On a motion to dismiss, the complaint "should be construed in the light most favorable to plaintiff", and such motion should be overruled "if it can reasonably be conceived that the plaintiff can make a case upon trial." **Jung v. K & D Mining Co.**, 260 F. 2d 607, 608 (7th Cir., 1958). In determining the sufficiency of a complaint, the accepted rule is "that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." **Conley v. Gibson**, 355 U. S. 41, 45, 46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957).

The complaints alleged breaches of duty and violations of the Act by respondents (1) in approving and paying fees under the Slayton Associates contract, (2) in failing to have the Jaquith contract approved and making the payments under this illegal contract, and (3) in causing a deviation from stated policy.

1. These respondents knowingly approved contracts for advisory service each year for five years with a corporation which they knew was not performing the services for

which it was being paid, which had abdicated and illegally assigned is contract to the brokers (R. 5, 6, 15). Slayton Associates (the alter-ego of the inside directors) was employed by the Fund as the disclosed investment adviser "pursuant to successive written contracts . . ." from August 15, 1952, and continuing until the date of the commencement of this action (R. 15). The outside directors' affirmative acts in knowingly renewing the lucrative contracts with this shell corporation were positive breaches of their statutory duty. These affirmative acts permitted the payment of over $1,000,000 for services which were not rendered. But for such approval, required by Section 15 (c), there would have been no authority for such payment.

2. At the same time the respondents approved the above contracts, they knowingly permitted the Fund to operate with a broker-adviser whose contract was not disclosed or approved by stockholders, nor formally approved by themselves (R. 5, 6, 15, 16). They are alleged to have aided and abetted in the paying out of over $1,500,000 to the brokers under this second unlawful contract (*Ibid.*) This, then, is not mere negligence, but gross misconduct based upon respondents' own positive acts, and when the Fund under that management performed the contract they violated the prohibitions of the statute.

3. It is alleged that "the acts of the defendants have violated the primary and principal policy of 'capital growth'" (R. 16). The complaints specify that what was done was to churn the portfolio and to distribute the capital gains (dividends)—again the declaration of dividends, is a familiar function of the board of directors (R. 16). This was for the benefit of the "insiders" (R. 6). The policy followed by these directors resulted in gross "mismanagement" to the benefit of the insiders (R. 6).

Petitioner's complaint alleged breaches by respondents of the specific duties imposed by the Act and violations of the Act by respondents. The Trial Court, therefore, properly ruled that it had jurisdiction.

CONCLUSION: The issue here is neither non-feasance nor mere negligence. The issue here is liability of directors for irresponsible violation of law in the management of other people's money. Even when they do not directly profit by the unlawful operation, they must be held to have accepted the responsibility, powers and duties specifically imposed by the statute. As joint tort feasors, they must be held to respond in damages if they breach the very duties the law imposes upon them.

The Court of Appeals overlooked new standards of responsibility for both inside and distinterested directors, new duties in safeguarding and preventing self-dealing operations. The action against these directors is for damages. The Fund must, of course, prove damages proximately caused by respondents' breach of statutory duty and violations of the Act. For such damages petitioner should be entitled to recover from respondents. That is why Congress made illegal the corporate acts approved by these directors and created a new substantive law requiring specific corporate procedures in entering into, and supervising, self-dealing advisory contracts,—and imposing the penalties and sanctions of illegality and voidness, in case of any departure from these statutory procedures.

Some of the directors are located in various parts of the country and this is why the Congress included in Section 44 the long-arm provision for service of process. Such a case should be tried in a Federal tribunal with all joint tort-feasors before the Court. A body of Federal law should evolve construing this Act. **Textile Workers Union**

v. Lincoln Mills, 353 U. S. 448, 1 L. Ed. 2d 972, 77 S. Ct. 912 (1957).

For all the foregoing reasons, it is respectfully submitted that this Court reverse the decision of the Court of Appeals dismissing respondents from the action.

Respectfully submitted,

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APPENDIX.

(Statute and Rule Involved.)

Sections 1 (b) (1), (2), (4), and (6), Sections 80a-1 (b) (1), (2), (4) and (6) of Title 15, U. S. C.:

"(b) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 79z-4 of this title, and facts otherwise disclosed and ascertained, it is declared that the national public interest and the interest of investors are adversely affected—

"(1) when investors purchase, pay for, exchange, receive dividends upon, vote, refrain from voting, sell, or surrender securities issued by investment companies without adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management;

"(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders;

"(4) when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably

distributed, or when investment companies are managed by irresponsible persons;

"(6) when investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders;

"It is declared that the policy and purposes of this subchapter and sections 72 (a) and 107 (f) of Title 11, in accordance with which the provisions of this subchapter and sections 72 (a), and 107 (f) of Title 11 shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors. Aug. 22, 1940, c. 686, Title I, § 1, 54 Stat. 789."

Section 9 (a), Section 80a-9 (a) of Title 15, U. S. C.:

"(a) It shall be unlawful for any of the following persons to serve or act in the capacity of officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust or registered face-amount certificate company:"
(here follows a list of persons disqualified from serving.)

Section 10 (a), Sections 80a-10 (a) of Title 15, U. S. C.:

"(a) After one year from the effective date of this subchapter and sections 72 (a) and 107 (f) of Title 11, no registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are investment advisers of, affiliated persons of an investment adviser

of, or officers or employees of, such registered company."

Sections 15 (a) and (c), Section 80a-15 (a) and (c) of Title 15, U. S. C.:

"(a) After one year from the effective date of this subchapter and sections 72 (a) and 107 (f) of Title 11 it shall be unlawful for any person to serve or act as investment advisor of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, unless in effect prior to March 15, 1940, has been approved by the vote of a majority of the outstanding voting securities of such registered company and —

"(1) precisely describes all compensation to be paid thereunder;

"(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

"(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

"(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser."

. . . . . .

"(c) In addition to the requirements of subsections (a) and (b) of this section it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, except a written agreement which was in effect prior to March 15, 1940, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party, or (2) by the vote of a majority of the outstanding voting securities of such company."

Section 8 (b) (2), Section 80a-8 (b) (2), of Title 15, U. S. C.:

"(b) Every registered investment company shall file with the Commission, within such reasonable time after registration as the Commission shall fix by rules and regulations, an original and such copies of a registration statement, in such form and containing such of the following information and documents as the Commission shall by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors:

. . .

"(2) a recital of the policy of the registrant in respect of matters, not enumerated in paragraph (1) of this subsection, which the registrant deems matters of fundamental policy and elects to treat as such;"

Section 13 (a) (3), Section 80a-13 (a) (3) of Title 15, U. S. C.:

"(a) No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities—

. . . . . .

"(3) deviate from its policy in respect of concentration of investments in any particular industry or group of industries as recited in its registration statement, or deviate from any fundamental policy recited in its registration statement pursuant to section 80a-8 (b) (2) of this title;"

Section 44, Section 80a-43 of Title 15, U. S. C.:

"The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter and sections 72 (a) and 107 (f) of Title 11, or the rules, regulations, or orders thereunder and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and sections 72 (a) and 107 (f) of Title 11 or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 80a-33 of this title, or upon a failure to file a report or other document required to be filed under this subchapter and sections 72 (a) and 107 (f) of Title 11, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and sections 72 (a) and 107 (f) of Title 11 or rules, regulations, or orders thereunder, may be brought in any such district

or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28 and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter and sections 72 (a) and 107 (f) of Title 11 brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title I, § 44, 54 Stat. 844."

Section 47 (b), Section 80a-46 (b) of Title 15, U. S. C.:

"(b) Every contract made in violation of any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or of any rule, regulation, or order thereunder, and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, regulation, or order. Aug. 22, 1940, c. 686, Title I, § 47, 54 Stat. 845."

Rule 8 (a) of the Federal Rules of Civil Procedure:

"(a) **Claims for Relief.** A pleading which set forth a claim for relief, whether an original claim, counterclaim, cross-claim, or third-party claim, shall contain (1) a short and plain statement of the grounds upon which the court's jurisdiction depends, unless the court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief to which he deems himself entitled. Relief in the alternative or of several different types may be demanded."

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No. 37

In the Supreme Court of the United States

October Term, 1961

[redacted], petitioner

v.

[redacted], et al.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE [redacted] CIRCUIT

BRIEF FOR THE [redacted] AS AMICUS CURIAE

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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 87

MANAGED FUNDS, INC., PETITIONER

v.

J. JOHN BROUK, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

OPINION BELOW

The opinion of the court of appeals (R. 40–71) is reported at 286 F. 2d 901.

JURISDICTION

The judgment of the court of appeals was entered on January 13, 1961 (R. 72). A petition for rehearing was denied on March 6, 1961 (R. 73). The petition for a writ of certiorari was filed on May 6, 1961 and was granted on June 19, 1961 (R. 74; 366 U.S. 958). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether an investment company can maintain an action against its directors based upon their violations of the Investment Company Act of 1940.

2. Whether the violations of the Act here charged are a proper basis for asserting liability.

STATUTE INVOLVED

The pertinent provisions of the Investment Company Act of 1940, 15 U.S.C. 80a–1, *et seq.*, are set forth in the Appendix, *infra*, pp. 45–52.[1]

STATEMENT

This is an action for damages and an accounting brought in the United States District Court for the Eastern District of Missouri by the petitioner ("the Fund"), an open-end registered investment company.[2] The suit is based on alleged violations of the Investment Company Act of 1940 ("the Act"). The defendants are present and former directors of the Fund (seven of whom—the so-called "outside direc-

[1] The Investment Company Act is contained in Section 80a of Title 15 of the United States Code. The numbering of the first 28 sections of the Act is the same in both the Act and the Code. Section 29 of the Act, however, was an amendment of the Bankruptcy Act, and does not appear in this portion of the Code. Beginning with Section 30 of the Act, therefore the section numbers in the Code are one number lower than in the Act. For example, Section 36 of the Act is Section 80a–35 of the Code.

[2] Section 5(a)(1) of the Investment Company Act of 1940 defines an open-end investment company as "a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer." Such companies are commonly referred to as "mutual funds."

tors"[3]—are the respondents before this Court); the investment adviser of the Fund (Slayton Associates, Inc.) and its two principals, Hilton and Hovey Slayton; and members and employees of a stock brokerage firm (Model, Roland and Stone) (R. 2–3).

The principal charges in the amended complaint (R. 1–12) were: (1) The defendants caused the Fund to pay substantial fees to an investment adviser whose contract had not been authorized by the Fund's shareholders, while at the same time paying more than $1,000,000 to another investment adviser who rendered no services. (This violated Section 15(a) of the Act, see *infra*, pp. 40–41.) (2) Although the stated policy of the Fund was to seek capital growth, the defendants instead followed a policy of making predetermined periodic distributions to its shareholders. (This violated Section 13(a)(3), see *infra*, p. 41.) The latter policy resulted in excessive purchases and sales of securities, which produced large commissions for the Fund's brokers at the expense of the Fund's securities portfolio. The complaint alleged (R. 3) that all of the "outside directors" had actual or constructive knowledge of the violations charged.

More specifically, the pertinent allegations of the amended complaint—and of the complaint in a stockholder's derivative action based on the same conduct (R. 12–20), which was consolidated in the district

[3] Section 10(a) of the Act provides that no more than 60 per cent of the Board of Directors of a registered investment company shall be investment advisers of, affiliated persons of an investment adviser of, or officers or employees of, such investment company. Only the seven "outside directors" appealed to the court of appeals. See *infra*, p. 6.

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court with the instant case (R. 28, 40)[4]—are as follows:

By contract dated August 15, 1952, the Fund employed Slayton Associates as its investment adviser, at an annual fee of one half of one per cent of the value of the Fund's assets (R. 4, 14–15). On December 1, 1953, Slayton Associates employed defendant Jaquith as investment counsellor and manager of the Fund's securities portfolio, at an annual fee of $50,000 for the first five years and a minimum of $35,000 a year for the next five years, to be paid through brokerage on the Fund's portfolio transactions (R. 5, 15). Under its investment advisory contract with the Fund, Slayton Associates was paid total fees of more than $1,000,000 over a six-year period, for which it performed no services (R. 5, 15–16). While receiving such fees, it "unlawfully delegated its duties thereunder to defendant Jaquith and abdicated its duties and responsibilities" thereunder (R. 5.)

Pursuant to his contract with Slayton Associates, Jaquith channeled the Fund's brokerage business to Model, Roland and Stone, a firm with which he was first associated and in which he later became a partner (R. 3, 5). Model, Roland and Stone received

[4] A stockholder's action was filed by one Josephson in the United States District Court for the District of Delaware (R. 13), shortly before the Fund filed its original complaint. The *Josephson* action was transferred to the Eastern District of Missouri. The Protective Casualty Insurance Company subsequently intervened in the case as a party plaintiff and adopted the *Josephson* complaint (R. 38, 42, 45). We shall treat the consolidated cases as a single case, and refer to the two complaints as "the complaint."

brokerage commissions on this business of more than $1,500,000 (R. 5). The defendants Smith and Stubbs (both of whom were employed by Model, Roland and Stone at the direction of Slayton Associates, one of whom was a former business associate of the Slaytons, and the other of whom was a brother-in-law of one of the Slaytons) shared in these brokerage commissions to the extent of more than $50,000 a year each, but performed no services for such payments (R. 3, 5, 15–16).

The Fund's investment policy, as announced in its prospectuses and in its registration statement filed with the Securities and Exchange Commission, was primarily to provide for capital growth, and to seek reasonable income consistent with that aim (R. 4). After the execution of the investment service contract between Jaquith and Slayton Associates, however, this policy was not followed. Instead, the Fund followed a policy of maintaining a predetermined amount of distributions on its shares from year to year. Since the income from the Fund's investments was not sufficient to make such distributions, the Fund had to realize gains through the sale of its securities (R. 5–6). This led to an increased number of purchases and sales by the Fund, which in turn produced greater fees for Jaquith and his partners in Model, Roland and Stone (R. 6, 16). This policy "resulted in gross mismanagement of, and loss and damage to, the investment portfolio" of the Fund (R. 6).

As a result of the foregoing operating changes, the registration statements, prospectuses and reports filed by the Fund with the Securities and Exchange Com-

mission contained false statements, which may lead to possible liability to investors (R. 7–8). In addition, the Fund was injured as a result of stop-order proceedings brought against it by the Commission because of the false statements (R. 8).

Pursuant to a conspiracy, Slayton Associates, Jaquith, and Model, Roland and Stone breached their fiduciary relationship with the Fund through mismanagement and waste of the Fund's assets (R. 9–10, 19). The Fund was operated and managed, and its portfolio securities were selected, in the interest of its directors, officers, investment advisers, other affiliated persons, and its underwriters, brokers and dealers, "rather than in the interest of all classes of [its] securityholders" (R. 6–7). The "outside directors" had knowledge both of the fiduciary relationship of the other defendants to the Fund, and of such defendants' mismanagement and waste, but failed to take any action to prevent it (R. 10–11).

All the defendants moved to dismiss on various grounds (R. 21–28), including the claim that the Act "does not confer jurisdiction on this Court of the claims attempted to be averred" (R. 21). The district court denied the motions without opinion (R. 28–30).

Upon appeal under the interlocutory appeals statute (28 U.S.C. 1292(b)) by the seven "outside directors," the Court of Appeals for the Eighth Circuit reversed, and directed dismissal of the complaint as to those defendants (R. 40–71). Pointing out that there is no "specific language [in the Act] creating civil liability respecting private actions," the court held that di-

rectors' liability to registered investment companies which they serve has not been created by implication (R. 49).

The court stated (R. 59) that the legislative history of the Act "afforded little assistance either in justifying or refuting the implication of a private right of suit such as claimed here." It ruled (R. 60), however, that the "failure [of Congress] to provide for any private civil remedies or for joint and several liability of directors and persons who commit or contribute to violations or for statutes of limitations or for conditions is persuasive that the omission was deliberate"; and that "[t]he enactments as they stand do not justify implications that jurisdiction was intended to be conferred." The court concluded (R. 71):

> * * * The complaints here substantially seek to hold these former directors to strict liability as insurers. The Act they rely on not only contains no such provision but plainly negates any intent to create such an innovation. The reliance upon implication to support the jurisdiction is not justified in the face of the legislative intent to exclude it.

SUMMARY OF ARGUMENT

I

The principal issue in this case is whether a registered investment company can maintain an action for damages and for an accounting against its directors, based on their violations of the Investment Company Act. While the Act does not expressly authorize such

an action, it should be permitted under the settled rule that where a "disregard of the command of the statute * * * results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied * * *" (*Texas & Pacific Ry.* v. *Rigsby*, 241 U.S. 33, 39). The complaint charged that all the defendants, including the directors, had violated the Act by operating the Fund in the interest of insiders rather than of investors. The Act was intended to protect investors from such mismanagement and, in order to make such protection effective, a private right of action by the company to recover damages for the statutory violations should be implied.

A. The doctrine of implied liability for statutory violations has been applied by the federal courts in a wide variety of situations to give private litigants a remedy for the violation of federal rights, where the statute creating such rights does not expressly provide for private enforcement. A private right of action will be implied when it will effectuate the basic design and policy of the legislation by redressing loss by the persons injured by the violation; and it will be implied for violation of particular statutory provisions even though private actions are expressly provided for violations of other sections of the same act. Since the theory of such an action is that it must be *implied* to effectuate the statutory design, it will not be defeated by the lack of *express* support therefor in the legislative history. Thus, where a private right of action appears necessary and appropriate to

implement a statute, it will be implied unless Congress affirmatively indicated an intention to bar such action—as it would by giving the government exclusive authority to enforce the statute.

B. Effectuation of the basic design of the Investment Company Act requires that a private right of action be implied for statutory violations. The Act was passed as the result of an extensive investigation by the Securities and Exchange Commission which disclosed a wide variety of improper practices by investment company managements which had seriously injured investors in such companies. Among the specific improper practices which Congress declared it was the policy of the Act to eliminate were the management of investment companies in the interests of insiders rather than of security holders; the management of such companies by irresponsible persons; and the change in the character of the business without the consent of security holders (Sections 1(b)(2), 1(b)(4), 1(b)(6)).

In order to eliminate and prevent the abuses that had been disclosed, Congress enacted a broad regulatory statute which governs in detail the organization, management and operation of investment companies. Congress carefully specified the duties and obligations of persons who, through their participation in, and affiliation with, investment company management and operation, control the vast assets possessed by these companies. Numerous provisions of the Act not only regulate the practices of the companies, but also impose specific prohibitions and duties upon directors.

Since Congress has provided these intricate and

detailed provisions for the protection of the shareholders in investment companies, it is natural to infer that Congress intended these statutory rights to be enforced by the very persons for whose benefit they were created. For the courts consistently imply a private right of action in favor of those whose interest the legislation was designed to protect. Furthermore, such a private right of action should exist not only in favor of the shareholders individually, but also in favor of shareholders collectively, *i.e.*, the investment company itself.

As the court of appeals recognized (R. 59), the legislative history of the Investment Company Act is silent on whether investment companies and their shareholders can maintain private actions for violation of the Act. Under the settled principles governing liability for violation of statutory duties, however, the right to bring such an action will be implied unless there is some affirmative indication that Congress did not intend it. There is no such indication here. On the contrary, the clear indication in the legislative history that Congress intended to take all steps necessary to protect investors against the serious abuses that had developed in the investment company industry is persuasive support for the implication of private actions designed to further that obective.

The fact that in other statutes Congress has sometimes specifically made directors liable for statutory violations is no basis for rejecting such implication here. If that contention were sound, there could never be any implied right of action for violation of a federal statute, since it could always be argued that if

Congress intended to impose liability it would have expressly done so. Nor do the statutory provisions authorizing the Commission to seek injunctive relief and imposing criminal penalties for willful violations, obviate the need for private actions to restore the losses suffered by the victims of the statutory violations.

C. The conclusion that a private right of action exists for violations of the Investment Act is supported not only by the general design of the Act and its legislative history, but by various specific statutory provisions which imply, although they do not expressly provide for, such actions. For example, Section 44 gives district and state courts concurrent jurisdiction of "all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of," the Act. The present suit, in which the Fund seeks recovery of the damages which it suffered from the defendants' violations of various duties and prohibitions that the Act imposes upon them, is one to "enforce [a] liability or duty created by" the Act. Section 47(b), which provides that contracts in violation of the Act are void, would be of little effect unless the victims of such illegal contracts have the right to obtain relief therefrom and to recover damages caused thereby. See also, Section 17(h), which prohibits the exculpation of any investment company director or officer from any liability to the company or its security holders to which he would otherwise be subject by reason of certain kinds of misconduct; and Section 38(c), which provides that no provision of the Act "imposing any liability" shall apply to any act

done or omitted in good faith in conformity with any Commission rule, regulation or order that may later be found invalid.

D. The existence of a private right of action for violation of the Investment Company Act is further supported by the almost unanimous weight of judicial authority, which has upheld such actions both under that Act and under other federal securities acts. With the exception of the decision below, every federal court that has considered the question has recognized that a private right of action exists for violation of the Investment Company Act. In addition, private rights of action have been consistently recognized for violation of the Securities Exchange Act of 1934 and the Securities Act of 1933. In view of the broad extent to which private remedies have been recognized for violations of the latter statutes, it would indeed be strange if such remedies do not also exist for violations of the Investment Company Act, which provides far more comprehensive protection to shareholders than the former Acts.

II

The complaint properly alleges, on behalf of the Fund, a liability against the directors based on their violations of the Act.

A. The acts charged against the defendants in this case violated specific provisions of the Act. The allegation that Slayton Associates employed Jaquith as the Fund's investment adviser, and thus in effect assigned its investment advisory contract with the Fund to Jaquith, charged a violation of Section 15(a), which prohibits a person from serving as an invest-

ment adviser of a registered company except pursuant to a written contract approved by a majority of the shareholders. The allegation that the Fund departed from its basic policy of providing for capital growth (and, instead, followed a policy of making predetermined annual distributions that were not earned and could only be paid by selling portfolio securities to produce capital gains), charged a violation of Section 13(a)(3), which prohibits any registered company from deviating from any fundamental policy recited in its registration statement, except upon the affirmative vote of a majority of its outstanding voting shares. These two statutory violations were particularly serious because they facilitated the practices which allegedly permitted the insiders to profit at the expense, and to the detriment, of the Fund and its shareholders—namely, the making of substantial payments to Slayton Associates for which no services were rendered; and the "churning" of the Fund's portfolio securities, which produced substantial commissions for Jaquith and other members of his brokerage firm. While the particular statutory provisions which the respondents are alleged to have violated do not, in terms, specifically apply to directors, all of the statutory prohibitions and obligations that the Act imposes upon registered investment companies necessarily also apply to the directors who govern the company. The complaint in this case, therefore, charges that the directors have breached their statutory fiduciary obligations toward the Fund by participating in the illegal acts alleged.

B. The court of appeals erred in concluding (R. 71) that the complaint sought to hold the seven independent directors liable as insurers. The complaint alleged (R. 6–7) that "the defendants committed, or with actual or constructive knowledge * * * aided, abetted, acquiesced in or condoned" specific violations of the Act; and that the seven independent directors had actual or constructive knowledge of the acts charged (R. 2–3, 11–12). The complaint thus charged that the independent directors had personally and knowingly participated in the statutory violations.

ARGUMENT

I

A REGISTERED INVESTMENT COMPANY HAS AN IMPLIED RIGHT OF ACTION FOR DAMAGES AGAINST ITS DIRECTORS FOR THEIR VIOLATION OF THE INVESTMENT COMPANY ACT OF 1940

The principal issue in this case is whether a registered investment company can maintain an action for damages and an accounting against its directors, based on their violations of the Investment Company Act. The Act does not expressly authorize such a private suit, and the court of appeals held (R. 49) that "directors' liability to registered investment companies which they serve" has not been created "by implication," since the language of the Act, as well as its legislative history, "shows that it was the legislative intent to refrain from entering the field of director responsibility" (R. 68).[5]

[5] As we show below (pp. 23–24), Congress did "enter * * * the field" of "director responsibility."

This holding is contrary to the general rule that if the purpose of a statute is to protect a particular segment of society, a violation will result not only in the imposition of the sanctions provided by the statute, but also in a right of recovery in favor of those persons in the protected group who have suffered from the unlawful act. It is well settled that

> A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied * * *. [*Texas & Pacific Ry.* v. *Rigsby,* 241 U.S. 33, 39.]

Accord: *Fairport P. & E. R. Co.* v. *Meredith,* 292 U.S. 589, 596–597; Restatement, Torts, Sec. 286. See, also, *Bell* v. *Hood,* 327 U.S. 678, 684 ("* * * where federally protected rights have been invaded, it has been the rule from the beginning that courts will be alert to adjust their remedies so as to grant the necessary relief").

The complaint in this case charged that all the defendants, including the directors of the Fund, had committed serious violations of the Act; and that such violations had substantially damaged the Fund (see the Statement, *supra,* pp. 3–6). The structure and the history of the Act show that it was intended to protect investors from the precise type of violation here charged—the operation of an investment company in the interest of insiders rather than of investors. In order to make such protection effective, a private right of action to recover damages for the

statutory violations should be implied. This conclusion is also supported by many lower court cases, which have consistently upheld the right to maintain private actions for violations not only of the Investment Company Act but also of other federal securities legislation administered by the Securities and Exchange Commission.

A. THE DOCTRINE OF IMPLIED LIABILITY

The doctrine of implied liability has been applied by the federal courts in a wide variety of situations to give private litigants a remedy for the violation of federal rights, where the statute creating such rights does not expressly provide for private enforcement.[6] A private right of action will be implied when it will effectuate the basic design and policy of the legislation by redressing loss by the persons injured by the violation; and it will be implied for violation of particular statutory provisions even though private actions are expressly provided for violation of other sections of the same act. See *infra*, pp. 26–27, 35–36. Moreover, since such rights of action are implied, they "are not contingent upon statutory language which affirmatively indicates that they are intended. On the contrary, they are implied unless the legislation evidences a contrary intention." *Brown* v. *Bullock*, 194 F. Supp. 207, 224 (S.D. N.Y.), appeal pending, C.A. 2, No.

[6] *E.g.*, *Tunstall* v. *Brotherhood of Locomotive Firemen*, 323 U.S. 210, 213 (Railway Labor Act); *Fitzgerald* v. *Pan American Airways, Inc.*, 229 F. 2d 499, 501 (C.A. 2) (Civil Aeronautics Act of 1938); *Reitmeister* v. *Reitmeister*, 162 F. 2d 691, 694 (C.A. 2) (Communications Act of 1934). See also the cases cited *supra*, p. 15.

26948; see *Narramore* v. *Cleveland, C., C. and St. L. R. Co.*, 96 Fed. 298, 300 (C.A. 6), certiorari denied, 175 U.S. 724; *Taussig* v. *Wellington Fund*, 187 F. Supp. 179, 217–219 (D. Del.)

The concept of implied liability is an outgrowth of the torts principle that violation of a statutory duty constitutes negligence toward the person for whose benefit the duty was created. Restatement, Torts, Sec. 286, see 2 Loss, *Securities Regulation* (2d ed., 1961), pp. 934–937. In the securities field, additional bases for implying a private right of action have been the statutory provisions declaring that contracts in violation of the act are void (see *Goldstein* v. *Groesbeck*, 142 F. 2d 422 (C.A. 2), certiorari denied, 323 U.S. 737; *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa.)), and granting the district courts jurisdiction of actions brought to enforce any duty or liability created by the act (*Remar* v. *Clayton Securities Corp.*, 81 F. Supp. 1014, 1017–1018 (D. Mass.); see *infra*, pp. 34–39).

Furthermore, since the theory of such an action is that it must be implied to effectuate the statutory design, it will not be defeated by the lack of express support in the legislative history. The principal significance of legislative history, therefore, is to ascertain whether Congress negated the existence of such implied private actions, either explicitly, or implicitly by giving the government the exclusive authority to enforce the statute. See *Amalgamated Workers* v. *Edison Co.*, 309 U.S. 261, 267–269; *Consolidated Freightways* v. *United Truck Lines*, 216 F. 2d 543 (C.A. 9), certiorari denied, 349 U.S 905. As we show

below (pp. 18–21, 24–26), the legislative history, although not dealing expressly with this question, does justify implied liability; in any event, it clearly does not negate it.

B. EFFECTUATION OF THE BASIC DESIGN OF THE ACT REQUIRES THAT A PRIVATE RIGHT OF ACTION BE IMPLIED FOR STATUTORY VIOLATIONS

1. The Investment Company Act is a comprehensive regulatory statute which governs in detail the organization, management and operation of investment companies. It resulted from an extensive investigation by the Securities and Exchange Commission, followed by lengthy congressional hearings, which disclosed a wide variety of improper practices by investment company managements that had seriously injured investors in such companies. The conditions that permitted such improprieties were explained by the Senate Committee as follows (S. Rep. No. 1775, 76th Cong, 3d Sess., p. 6):

> Basically the problems flow from the very nature of the assets of investment companies. The assets of such companies invariably consist of cash and securities, assets which are completely liquid, mobile and readily negotiable. Because of these characteristics, control of such funds offers manifold opportunities for exploitation by the unscrupulous managements of some companies. These assets can and have been easily misappropriated and diverted by such types of managements, and have been employed to foster their personal interests rather than the interests of public security holders. It is obvious that in the absence of regulatory legisla-

> tion, individuals who lack integrity will continue to be attracted by the opportunities for personal profit available in the control of the liquid assets of investment companies and that deficiencies which have occurred in the past will continue to occur in the future.

With respect to the major improprieties here charged—the change of investment advisers and of the Fund's basic investment policy, made without the consent of the shareholders (see the Statement, *supra*, pp. 3–5)—the Committee stated (*id.*, p. 7):

> A major problem in the case of management companies is created by the absence of any legal requirement for adherence to any announced investment policies or purposes. Such policies have often been radically changed without the knowledge or prior consent of stockholders. Similarly, after investors have invested in companies on their faith in the reputation and standing of the existing managements, control of the public's funds has frequently been transferred without the prior knowledge or consent of stockholders to other persons who were subsequently guilty of gross mismanagement of the companies.

The Committee further stated (*id.*, p. 11) that "[t]he conclusion is clear that the perpetrations of these misfeasances and the recurrence of these abuses cannot be completely abated nor the deficiencies eliminated without the enactment of adequate Federal legislation regulating these institutions." It pointed out (*id.*, p. 12) that representatives of the investment

company industry "recognized that the protection of investors against unscrupulous management and the necessity for the prevention of the recurrence of the abuses disclosed by the Commission's study and the committee hearings made indispensable the immediate enactment of adequate legislation regulating investment companies"; and that such representatives "urged that this legislation will serve the most salutary purpose of protecting small investors from breaches of trust; will afford investors a regulated and supervised institution in which to invest their savings * * *. The industry asserted, and the Commission and the committee believe, that this legislation will tend to prevent those abuses which have been a stigma upon and impaired the usefulness of the investment trust industry as a whole."

The House Committee made a similar explanation of the reasons for, and the aims of, the legislation. H. Rep. No. 2639, 76th Cong., 3d Sess., pp. 7–9.

In Section 1(b) of the Act, Congress declared that "the national public interest and the interest of investors are adversely affected"

* * * * *

> (2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers * * * or other affiliated persons thereof * * * [or] of underwriters, brokers, or dealers * * * rather than in the interest of * * * such companies' security holders;

* * * * *

> (4) * * * when investment companies are managed by irresponsible persons;
>
> * * * * *
>
> (6) when investment companies * * * change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders * * *.

Congress further stated (*ibid.*) that it is the "policy and purposes" of the Act "to mitigate and, as far as feasible, to eliminate" the various specified abuses; and that the provisions of the Act "shall be interpreted" in accordance with such policy and purposes.

2. In order to eliminate and prevent the serious abuses by investment companies that had been disclosed, Congress enacted broad regulatory legislation. The Act went far beyond the earlier federal securities acts, which were primarily disclosure statutes, since Congress concluded that mere disclosure legislation would not provide adequate protection to investment company shareholders. See S. Rep. No. 1775, 76th Cong., 3d Sess., pp. 11–12; H. Rep. No. 2639, 76th Cong., 3d Sess., p. 10. Congress provided for detailed regulation of virtually all aspects of the investment company industry. It carefully specified the duties and obligations of persons who, through their participation in and affiliation with investment company management and operation, control the vast assets possessed by these companies.

The Act requires that investment companies register with the Commission, and prohibits interstate transactions by unregistered companies (Sections 8 and 7).

Specific requirements are imposed for the corporate and capital structures of registered investment companies (Section 18), and various transactions between registered companies and their affiliates and underwriters are prohibited except with Commission approval (Section 17). Limitations are imposed upon the payment of dividends (Section 19) and upon the solicitation of proxies (Section 20(a)), and the sale of voting trust certificates is prohibited (Section 20(b)). Unless authorized by the holders of a majority of its outstanding shares, a registered investment company cannot deviate from any fundamental policy recited in its registration statement filed with the Commission (Section 13(a)(3)).

Restrictions are placed upon the purchase and sale of portfolio securities by investment companies (Section 12), and upon the distribution and repurchase of their own shares (Sections 22, 23). The Act makes it unlawful for any person to serve as an investment adviser of a registered company, except pursuant to a written contract that has been approved by a majority of the company's outstanding voting shares (Section 15(a)). To be valid, such an investment advisory contract must provide for its automatic termination if it is assigned by the investment adviser (Section (15(a)(4)). There are also provisions which govern the standards and procedures for reorganization of investment companies (Section 25); require the filing with the Commission, and the transmittal to stockholders, of various reports by registered companies (Section 30); provide for the maintenance of accounts and records (Section 31); and give the stockholders

control over the selection of accountants and auditors (Section 32). Larceny and embezzlement from a registered investment company are made federal crimes (Section 37).

In addition to the provisions which regulate the practices of investment companies generally, the Act also deals specifically with directors. For example, Section 10 requires that at least 40 percent of the directors be unaffiliated with the investment adviser of the investment company, and that at least 50 percent be unaffiliated with the principal underwriter. (The respondents before this Court are the Fund's unaffiliated or "independent" directors.) Section 30(f) bars certain "insiders" of registered closed-end investment companies, including directors, from profiting on purchases and sales of their company's equity securities made within a six-month period. Section 36 authorizes the Commission to bring an action for gross misconduct or gross abuse of trust against, among others, directors of registered investment companies; and, if such allegations are established, directs the court to enjoin such persons, either permanently or temporarily, from acting in such capacity. In addition, all of the restrictions which the Act imposes upon "affiliates" of registered investment companies in their dealings with such companies (*e.g.*, Sections 17, 32(a)(1)) are applicable to directors, since Section 2(a)(3)(D) defines "affiliated person" to include director.

The court of appeals was thus plainly in error in ruling (R. 68) that "it was the legislative intent to refrain from entering the field of director responsi-

bility." Congressional concern with insuring the highest standards of "director responsibility" is manifest not only from the face of the statute, but from the numerous references in the Committee reports to the duties of, and the disabilities being imposed upon, directors of registered investment companies. S. Rep. No. 1775, 76th Cong., 3d sess., pp. 7, 14, 15; H. Rep. No. 2639, 76th Cong., 3d Sess., pp. 9, 14, 17, 18. Furthermore, the various statutory provisions governing the conduct of investment companies also impose upon the directors the duty of compliance therewith. See *infra*, p. 41.

3. Since Congress has provided these intricate and detailed provisions for the protection of the shareholders in investment companies, it is natural to infer that Congress intended these statutory rights to be enforced by the very persons for whose benefit they were created. As the court stated in *Goldstein* v. *Groesbeck*, 142 F. 2d 422, 427 (C.A. 2), certiorari denied, 323 U.S. 737, in holding that there was a right of action by stockholders of a registered holding company for violations of the Public Utility Holding Company Act of 1935:

> [A] denial of a private right of action to those for whose ultimate protection the legislation is intended leaves legislation highly publicized as in the public interest in fact sadly wanting, and even delusive, to that end.

Similarly, in *Brown* v. *Bullock*, 194 F. Supp. 207, 246 (S.D. N.Y.), pending on appeal, C.A. 2, No. 26948, the court, in holding that there is a federal private right of action for damages based on conduct by in-

vestment company officers, directors and affiliates which constituted a "gross abuse of trust" within the meaning of Section 36 of the Act, stated:

> The indifference to federal civil liability for "gross misconduct or gross abuse of trust" attributed by defendants to Congress cannot be reconciled with the emphatically expressed purpose of Congress to eliminate those very evils and to protect investors against those very abuses.

There is, of course, a means by which the law avoids such an anomalous result. Where a statute does not give those whose interest it was designed to protect the express right to maintain an action to vindicate their rights, the courts consistently imply the right of action. See *supra,* pp. 14–17.

A private right of action for violation of the Investment Company Act is necessary to give investors the full measure of the protection which Congress provided for them. Of course, the Act gives the Commission broad enforcement authority,[7] and provides criminal penalties.[8] But such provisions can, at

[7] Section 42(e) authorizes the Commission to bring proceedings in the district court to enjoin "any act or practice constituting a violation of any provision" of the Act or of any Commission rule, regulation or order, and authorizes permanent or temporary injunctive relief. In addition, Section 36 contains special provisions governing the granting of injunctive relief in cases of gross mismanagement or gross abuse of trust by certain investment company personnel and affiliates. See *supra*, p. 23.

[8] Section 49 imposes criminal penalties for willful violations of the Act or of any Commission rule, regulation or order, and for willful misstatements in any document which the Act requires to be filed or transmitted.

best, accomplish only the termination of existing violations and the prevention and deterrence of future wrongs. They cannot restore the losses that the shareholders have already suffered from the violations. Those losses can be recovered only through a private action in which the violators will be required to make the victims whole. Such a private action is thus necessary to achieve fully "the protection of investors against unscrupulous management" (S. Rep. No. 1775, 76th Cong., 3d Sess., p. 12) which Congress sought to provide; it also serves the salutary purpose of imposing an additional sanction that will tend to deter violations.

Furthermore, a private right of action against directors who violate the Act should exist not only in favor of the shareholders, but also in favor of the investment company itself. The reason for permitting a private action is that it will effectuate the basic purpose of the Act of protecting shareholders in investment companies from mismanagement. That objective is fully achieved when the malefactors are required to account to the stockholders collectively, *i.e.*, the company, for the injuries they have inflicted by their statutory violations.

4. Both the court of appeals (R. 57) and the respondents (Br. in opp., for respondents *Brouk, et al.*, p. 11) state that where Congress intends to impose director liability, it specifically so provides. They cite a provision of the National Bank Act which authorizes private actions against directors who knowingly violate or permit violations of that Act (12 U.S.C. 93). If this contention were sound, there could never be any implied right of action for viola-

tion of a federal statute. For it could always be argued that if Congress intended to impose liability, it would have done it expressly.

The argument has been rejected under the 1933 and 1934 Acts, and it should be rejected here. Those statutes specifically provide for civil actions for violation of certain sections. Private actions have been implied, however, for violation of other sections for which no right of action is provided. *Thiele* v. *Shields*, 131 F. Supp. 416 (S.D.N.Y.) (1933 Act); *Fratt* v. *Robinson*, 203 F. 2d 627 (C.A. 9) (1934 Act); *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa.) (1934 Act).

5. As the court of appeals recognized (R. 59), the legislative history of the Investment Company Act is silent on whether investment companies and their shareholders can maintain private actions for violation of the Act. Under the settled principles governing liability for violation of statutory duties, however, the right to bring such an action will be implied unless there is some affirmative indication that Congress intends to preclude it (see *supra*, pp. 16–17). There is no such indication here. Moreover, although the legislative history does not in terms deal with this issue, the clear indication that Congress intended to take whatever steps were necessary to protect investors against the serious abuses that had developed in the industry (see *supra*, pp. 18–21) is persuasive support for the existence of private actions designed to further that objective.

The court of appeals, noting that the Act represented a compromise reached by negotiation between

the Commission and industry representatives, concluded that it was unlikely that the industry would have supported the legislation had it believed that private rights of action for violations of the Act would be implied (R. 60). But the industry representatives themselves recognized the need for stringent regulation to correct and prevent the abuses that had developed. S. Rep. No. 1775, 76th Cong., 3d Sess., p. 7; H. Rep. No. 2639, 76th Cong., 3d Sess., p. 10. Indeed, the industry agreed to far more onerous burdens and restraints than the imposition of civil liability for statutory violations.* The fact that the industry representatives agreed to the Act provides no basis for the claim that Congress intended to bar private rights of action.

C. NUMEROUS PROVISIONS OF THE ACT IMPLY THE EXISTENCE OF PRIVATE DAMAGE SUITS FOR STATUTORY VIOLATIONS

The conclusion that a private right of action exists for violations of the Investment Company Act is supported not only by the general design of the Act and its legislative history, but by various specific provi-

*Thus, an industry spokesman supported the view that larceny and embezzlement from an investment company should be made federal offenses. Hearings on H.R. 10065 Before a Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives, 76th Cong., 3d Sess., p. 124. The industry also accepted the provision in Section 36 that persons connected with an investment company who were guilty of gross mismanagement or gross abuse of trust would not only be removed from office, but might be permanently enjoined from serving with any investment company. S. Rep. No. 1775, 76th Cong., 3d Sess., pp. 1–2; H. Rep. No. 2639, 76th Cong., 3d Sess., p. 5.

sions which plainly imply, although they do not expressly provide for, such actions.

1. Section 44 of the Act gives the district courts jurisdiction of violations of the Act and, concurrently with state and territorial courts,

> of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of,

the Act. It also specifies the district in which "[a]ny suit or action to enforce any liability or duty created by, or to enjoin any violation of" the Act, may be brought. This provision is substantially identical to the jurisdictional provisions of the Securities Exchange Act of 1934 and the Public Utility Holding Company Act of 1935, under which private rights of action have been repeatedly recognized. See *infra*, pp. 34–39.

As we have shown, the Act imposes numerous specific duties upon directors and other persons connected with investment company managements. The complaint in this case charges all of the defendants, including the independent directors, with serious violations of those statutory duties, and seeks to recover the damages that the Fund suffered thereby. The instant suit is, therefore, one to "enforce [a] liability or duty created by" the Act within the meaning of Section 44, and one whose maintenance in the federal courts appears contemplated by that section.

This conclusion is further supported by the grant of jurisdiction to both federal and state courts to entertain actions both at law and in equity. The only

actions which the Act authorizes the Commission to bring are equity actions, and they may be brought only in the federal courts (Sections 25, 35, 36 and 42). Thus, the jurisdiction of the federal courts to entertain actions at law, and of the state courts to entertain actions both at law and equity, can cover only private actions. While this jurisdiction might be explained on the narrow ground that it covered only the section for the violation of which the Act expressly authorized private suits,[19] it is plainly broad enough also to cover private rights of action for violations of other sections.

2. Section 17(h) prohibits the exculpation of any investment company director or officer from any liability to the company or to its security holders "to which he would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office." Such liability could only be enforced through a private action by the company or its stockholders; and unless such an action were maintainable, there would be no need for a prohibition against exculpation.

[19] Section 30(f) permits recovery from investment company insiders of "short swing" trading profits in equity securities of closed-end investment companies. In 1954 the Act was amended to impose civil liability upon directors and others for misstatements in registration statements filed by investment companies under the Securities Act of 1933 (Section 24(e)(3), 68 Stat. 689).

While it is arguable that this provision was designed merely to prevent exculpation from liability under state law, such a narrow reading seems inconsistent with the broad phrase "the duties involved in the conduct of his office." As we have shown, the Act imposes a wide range of special duties upon officers and directors of registered investment companies, which go far beyond those which state law traditionally imposes upon corporate officers and directors generally. Section 17(h) thus seemingly contemplates the existence of a private right of action against investment company officers and directors based on their "reckless disregard of the duties involved in the conduct of [their] office," *i.e.*, the duties imposed by the Act; and it prohibits exculpation from liability therefor.

3. Section 38(c) provides that no provision of the Act "imposing any liability shall apply to any act done or omitted in good faith" in conformity with any Commission rule, regulation or order that may later be found invalid. Although this provision may have been intended merely to insure that persons who acted in good faith reliance upon a Commission ruling would not thereafter be proceeded against by the Commission for such action, the language is not so restricted. A more persuasive interpretation is that Congress intended that no one would be subjected to "any" liability imposed by the Act for acting in reliance upon Commission approval. Such "liability" includes the liability for statutory violations that is enforced through private rights of action.

4. Section 47(b) provides that contracts made in violation of the Act, or the performance of which will violate the Act, are void. But the mere legislative declaration of such voidance, or the utilization of this provision by an investment company as a defense to an action based upon such contract, would be wholly inadequate to protect investment companies and their shareholders against such illegal contracts. If this provision is to be at all effective, the victim of such an illegal contract must be given the right to obtain relief therefrom and to recover damages for the losses caused thereby. As the court stated in *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa.), in relying upon the similar provision of the Securities Exchange Act of 1934 as a ground for upholding an implied right of action for violations of that Act:

> [A] statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it. The statute would be of little value unless a party to the contract could apply to the Courts to relieve himself of obligations under it or to escape its consequences.[11]

[11] The court of appeals, in attempting to distinguish this ruling in *Kardon*, stated (R. 52) that, unlike the situation in *Kardon*, none of the independent directors here was a party to either of the investment advisory contracts. But the Fund was a party to the original contract, and was the third-party beneficiary of the contract between Slayton Associates and Jaquith. It is the Fund, and not the independent directors, that is seeking to "apply to the courts to * * * escape its consequences" (*Kardon*, *supra*). In any event, privity of contract is not essential for the implication of a private remedy for statutory violations. At most, "[i]t is an evidentiary fact to be considered in conjunction with other material facts in determining whether the

See, also, *Goldstein* v. *Groesbeck*, *supra*, p. 24, involving a similar contract voiding provision of the Public Utility Holding Company Act of 1935.

D. THE EXISTENCE OF A PRIVATE RIGHT OF ACTION FOR VIOLATION OF THE INVESTMENT COMPANY ACT IS SUPPORTED BY THE ALMOST UNANIMOUS WEIGHT OF JUDICIAL AUTHORITY

The existence of a private right of action for violation of the Investment Company Act is further supported by the almost unanimous weight of judicial authority, which has upheld the existence of such actions both under that Act and under other federal securities acts.

1. *Decisions under the Investment Company Act.* With the exception of the decision below, every federal court that has considered the question has recognized that a private right of action exists for violation of the Investment Company Act. *Breswick & Co.* v. *Briggs*, 136 Supp. 301 (S.D. N.Y.); *Schwartz* v. *Bowman*, 156 F. Supp. 361 (S.D. N.Y.), appeal dismissed *sub nom. Schwartz* v. *Eaton*, 264 F. 2d 195 (C.A. 2); *Cogan* v. *Johnston*, 162 F. Supp. 907 (S.D. N.Y.); *Taussig* v. *Wellington Fund*, 187 F. Supp. 179 (D. Del.); *Brown* v. *Bullock*, 194 F. Supp. 207 (S.D. N.Y.), appeal pending, C.A. 2, No. 26948; see *Brown* v. *Eastern States Corporation*, 181 F. 2d 26, 28 (C.A. 4), certiorari denied, 340 U.S. 864. In a suit based on substantially the same alleged viola-

relationship (such as it is) between the plaintiffs and the defendants and the nature of the particular acts and transactions involve the duty created by the statute" (*Brown* v. *Bullock*, 194 F. Supp. 207, 230 (S.D. N.Y.), pending on appeal, C.A. 2, No. 26948).

tions of the Act as are charged in the instant case, and involving the Fund, a Delaware court recently upheld the existence of a private right of action. *Lutz* v. *Boas*, 171 A. 2d 381 (Del. Ch.). Most of these cases have relied heavily on the decisions sanctioning a right of action under the other federal securities acts.

In the *Schwartz* case, *supra*, the Court of Appeals for the Second Circuit stated (264 F. 2d at 198, n. 5) that it was "clear" that "such remedies [accounting, injunction and damages] may be had [in a private action] under the Investment Company Act."

2. *Decisions under other federal securities acts.* The principal development of the private right of action for violation of federal securities legislation has been under the Securities Exchange Act of 1934 (the "1934 Act"). The right was first recognized in *Baird* v. *Franklin*, 141 F. 2d 238 (C.A. 2), certiorari denied, 323 U.S. 737. There an investor was held entitled to maintain an action against the Treasurer of the New York Stock Exchange to recover damages suffered in the 1938 Richard Whitney scandal. The plaintiff's theory was that she had been injured because of the failure of the exchange to discipline Whitney, as required by Section 6(b) of the 1934 Act. Although the court denied recovery because there was no showing that the failure to discipline was the proximate cause of the plaintiff's damage, it ruled that a private action would lie for the statutory violation. Pointing out that the Act was intended to protect investors and to provide reasonably complete and effective control of secu-

rities transactions (141 F. 2d at 244–245), the court stated (*id.* at 245) that if this statutory purpose was to be achieved, Section 6(b)

> must be construed as granting to injured investors individual causes of action to enforce the statutory duties imposed upon the exchanges.

In the leading case of *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa.), a private right of action was held to exist in favor of a stockholder for violations of the anti-fraud provisions of the 1934 Act (Section 10(b), 15 U.S.C. 78j(b); Rule 10b–5 of the Commission's rules and regulations under the 1934 Act). The court rejected the argument that the fact that the Act specifically authorized private actions for violation of three other sections indicated a Congressional intent to exclude such actions for violation of Section 10(b). It stated (69 F. Supp. at 514):

> * * * Were the whole question one of statutory interpretation it might be convincing, but the question is only partly such. It is whether an intention can be implied to deny a remedy and to wipe out a liability which, normally, by virtue of basic principles of tort law accompanies the doing of the prohibited act. Where, as here, the whole statute discloses a broad purpose to regulate securities transactions of all kinds and, as a part of such regulation, the specific section in question provides for the elimination of all manipulative or deceptive methods in such transactions, the construction contended for by the defendants may not be adopted. In other words, in view of the general purpose of the

> Act, the mere omission of an express provision for civil liability is not sufficient to negative what the general law implies.

See, also, *Fratt* v. *Robinson*, 203 F. 2d 627, 631–633 (C.A. 9); cf. *Securities and Exchange Commission* v. *Joiner Corp.*, 320 U.S. 344, 350–352.

Since the *Kardon* decision, the existence of a private right of action for violation of the anti-fraud provisions of the 1934 Act has been recognized by every circuit which has considered the question.[12]

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[12] *Ellis* v. *Carter*, 291 F. 2d 270 (C.A. 9); *Matheson* v. *Armbrust*, 284 F. 2d 670 (C.A. 9), certiorari denied, 365 U.S. 870; *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C.A. 5), certiorari denied, 365 U.S. 814; *Reed* v. *Riddle Airlines*, 266 F. 2d 314, 315 (C.A. 5); *Fratt* v. *Robinson*, 203 F. 2d 627 (C.A. 9); *Errion* v. *Connell*, 236 F. 2d 447 (C.A. 9); *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (C.A. 2); *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808 (D. Del.), affirmed, 235 F. 2d 369 (C.A. 3). See *Slavin* v. *Germantown Fire Ins. Co.*, 174 F. 2d 799 (C.A. 3).

Birnbaum v. *Newport Steel Corp.*, 193 F. 2d 461 (C.A. 2), certiorari denied, 343 U.S. 956, was apparently relied on by the court below as authority for the view that "the courts have rejected implication of federal jurisdiction in director liability cases" (R. 53, 57–58). The *Birnbaum* case, however, does not deny the existence of a private right of action for violation of the 1934 Act. The only question in *Birnbaum* was whether the Commission's anti-fraud Rule X–10b–5, which the defendants were alleged to have violated, was "aimed only at 'a fraud perpetrated upon the purchaser or seller' of securities", or whether it also prohibited "breaches of fiduciary duty by corporate insiders resulting in fraud upon those who were not purchasers or sellers" (p. 463). The court held (p. 464) that "Rule X–10b–5 extended protection only to the defrauded purchaser or seller"; and that "[s]ince the complaint failed to allege that any of the plaintiffs fell within either class," the district court had properly dismissed the complaint for failure to state a cause of action.

The decision in the *Birnbaum* case, therefore, involved only the narrow question of the construction of the Commission's

The right to maintain a private action for violation of the provisions of the 1934 Act governing the solicitation of corporate proxies has also been widely recognized. See Loss, *The S.E.C. Proxy Rules in the Courts*, 73 Harv. L. Rev. 1041. With one distinguishable exception,[12] the courts have consistently upheld

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Rule X-10b-5, and the court held only that the rule did not prohibit the particular conduct there challenged. Nothing in the opinion even remotely suggests that a private action for violation of the rule would not lie if brought by a person entitled to its protection (*i.e.*, a defrauded purchaser or seller). The court cast no doubt upon its prior decisions in the *Fischman* case, *supra*, which had permitted a defrauded purchaser to maintain an action for damages based on violations of Section 10b and Rule X-10b-5; or upon the *Baird* case (*supra*, p. 34), which also recognized the existence of a private right of action for violation of the 1934 Act.

The court below also apparently relied (R. 55-56) upon *Downing* v. *Howard*, 162 F. 2d 654 (C.A. 3), certiorari denied, 332 U.S. 818. There the court upheld the dismissal of a private action based upon alleged violations of the Public Utility Holding Company Act of 1935. The ground of decision, however, was not that a private right of action would not be implied for violation of that Act; on the contrary, the court specifically refused to accept the broad contention that "violation of the registration provisions of the statute will never bring about individual liability" (162 F. 2d at 658). The holding of the court in *Downing* was only that the complaint had been properly dismissed because it failed to show that the statutory violations charged had caused the damage alleged. *Id.* at 658-659.

[12] In *Howard* v. *Furst*, 288 F. 2d 790 (C.A. 2), certiorari denied, 353 U.S. 937, the court refused to permit a stockholder to maintain, on behalf of his corporation, a derivative action against the directors. The claim was that, in order to advance their personal interests, the directors had sold all of the company's assets for less than their value; and that the stockholders' approval of such sale was obtained through a proxy statement that was false and misleading, in violation of

such actions.[14] Stockholders have also been held to have the right to sue brokers for losses suffered

Section 14(a) of the 1934 Act and the Commission's proxy rules. The court held (p. 793) that the 1934 Act did not "create any rights whatever in a corporation whose stockholders may be solicited by proxy statements prepared in contravention of the statutory mandate"; it expressly left open, however, "the question of whether and to what extent Section 14(a) may be construed as creating substantive rights in an individual stockholder" (*ibid.*). The court further held (pp. 793–794) that since the substantive claim that the directors had improperly sold corporate property for less than its value depended upon New York law, the case did not "arise under" the laws of the United States merely because it was contended that such illegal sale had been accomplished through a false proxy statement.

The narrow ruling in *Howard* that a corporation (as distinguished from its stockholders) cannot maintain an action based on violations of the proxy provisions of the 1934 Act has been criticized. 2 Loss, *Securities Regulation* (2d ed., 1961), pp. 949–950. In any event, it does not cover the different—and broader—question here involved. The court in *Howard* relied on the legislative history of the 1934 Act, which, in its view, indicated that Congress did not intend to extend the protection of the proxy provisions of that Act to corporations, as distinguished from the individual shareholders. As we have shown, however, numerous provisions of the Investment Company Act, as well as its legislative history, indicate a clear Congressional intent to protect the company as well as its shareholders.

Significantly, the court in *Howard* did not question the general principle, which it previously had recognized (see note 12, *supra*, pp. 36–37), that a private right of action for violation of federal securities legislation will be implied where necessary to effectuate the basic statutory design. As we have shown, that is the situation in the instant case.

[14] *Dann* v. *Studebaker-Packard Corp.*, 288 F. 2d 201 (C.A. 6); *Tate* v. *Sonotone Corp.*, 5 S.E.C. Jud. Dec. 310 (S.D. N.Y.); *Horowitz* v. *Balaban*, 112 F. Supp. 99 (S.D. N.Y.); *Textron* v. *American Woolen Co.*, 122 F. Supp. 305, 308 (D. Mass.); *Weeks* v. *Alpert*, 131 F. Supp. 608 (D. Mass.); *Doyle*

through loans made in violation of the margin requirements under the 1934 Act.[15]

Private rights of action have also been recognized under the Public Utility Holding Company Act of 1935 and the Securities Act of 1933. A stockholder has been permitted to maintain a derivative action for an accounting for profits received under service contracts that violated the Holding Company Act.[16] A private right of action has also been recognized for violation of the proxy provisions of that Act.[17] Recovery was permitted under the anti-fraud provisions of the 1933 Act, which make no provision for private actions, even though other sections of that statute do expressly provide for private damage actions.[18]

In view of the broad extent to which private remedies have been recognized for violations of the Securities Exchange Act of 1934, it would be strange indeed if such remedies do not also exist for violations of the Investment Company Act. For the latter Act

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v. *Milton*, 73 F. Supp. 281, 285 (S.D. N.Y.); *Dunn* v. *Decca Records, Inc.*, 120 F. Supp. 1 (S.D. N.Y.); *Curtis* v. *American Tel. & Tel. Co.*, 124 F. Supp. 197 (S.D. N.Y.); *Rosen* v. *Alleghany Corp.*, 133 F. Supp. 858, 867–869 (S.D. N.Y.); *Mack* v. *Mishkin*, 172 F. Supp. 885, 889 (S.D. N.Y.); *Central Foundry Co.* v. *Gondelman*, 166 F. Supp. 429 (S.D. N.Y.).

[15] *Remar* v. *Clayton Securities Corp.*, 81 F. Supp. 1014 (D. Mass.); *Appel* v. *Levine*, 85 F. Supp. 240 (S.D. N.Y.); *Reader* v. *Hirsch & Co.*, CCH Fed. Securities Law Rep. ¶91044 (S.D. N.Y.).

[16] *Goldstein* v. *Groesbeck*, 142 F. 2d 422 (C.A. 2), certiorari denied, 323 U.S. 737, discussed *supra*, p. 24.

[17] *Phillips* v. *The United Corp.*, 5 S.E.C. Jud. Dec. 445 (S.D. N.Y.).

[18] *Thiele* v. *Shields*, 131 F. Supp. 416 (S.D. N.Y.).

provides far more detailed regulation than either the 1934 Act or the Securities Act of 1933. As we have shown, the Investment Company Act subjects almost every aspect of the industry to specific requirements and prohibitions, designed to protect investment companies and their shareholders from mismanagement (see *supra*, pp. 21–23). If private actions are necessary for the protection of stockholders' rights under the 1934 and 1933 Acts, *a fortiori* they are necessary to effectuate the more comprehensive shareholder protection given by the Investment Company Act.

II

THE COMPLAINT PROPERLY ALLEGES, ON BEHALF OF THE FUND, A LIABILITY AGAINST THE DIRECTORS BASED ON THEIR VIOLATIONS OF THE ACT

A. THE COMPLAINT CHARGES THE DIRECTORS WITH VIOLATING THEIR STATUTORY DUTIES TOWARD THE FUND

In the present case, the conduct with which the defendants are charged violated specific provisions of the Act. The allegation that Slayton Associates employed Jaquith as the Fund's investment adviser, and thus in effect assigned its investment advisory contract with the Fund to Jaquith, charged a violation of Section 15(a), which prohibits a person from serving as an investment adviser of a registered company except pursuant to a written contract approved by a majority of the shareholders. While the shareholders presumably approved the employment of Slayton Associates, they had not approved the employment of Jaquith (R. 7, 16). Indeed, if the investment advisory contract with Slayton Associates was in conformity with the Act, it terminated automatically

upon its assignment to Jaquith (Section 15(a)(4)).

The complaint also alleged that, following the employment of Jaquith as an investment adviser, the Fund departed from its basic policy, set forth in its registration statement, that its primary purpose was to provide for capital growth; and that instead it followed a policy of making predetermined annual distributions, which in fact were not earned and which could be paid only by selling portfolio securities to produce capital gains. These allegations charged a violation of Section 13(a)(3), which prohibits any registered company from deviating from any fundamental policy recited in its registration statement, except upon the affirmative vote of a majority of its outstanding voting securities.

These two statutory violations were particularly serious because they facilitated the practices which allegedly permitted the insiders to profit at the expense and to the detriment of the Fund and its shareholders—namely, the making of substantial payments to Slayton Associates for which no services were rendered; and the "churning" of the Fund's portfolio securities, which produced substantial commissions for Jaquith and the other members of the brokerage firm of Model, Roland & Stone.

The particular statutory provisions which the respondents are alleged to have violated do not, in terms, specifically apply to directors. But it is the directors who govern the company, and the various prohibitions and obligations that the Act imposes upon registered investment companies necessarily also apply to the directors. The complaint in this case, therefore,

charges that the directors have breached their statutory fiduciary obligations toward the Fund by participating in the illegal acts alleged.

B. THE DIRECTORS ARE NOT SOUGHT TO BE HELD AS INSURERS

The court of appeals erred in concluding (R. 71) that the complaint sought recovery from the seven independent directors on the basis of their allegedly "strict liability as insurers." On the contrary, the complaint alleged (R. 6–7) that "the defendants committed, or with actual or constructive knowledge * * * aided, abetted, acquiesced in or condoned," directly or indirectly, the following specific violations of the Act:

> (1) The Fund deviated from a fundamental policy recited in its registration statement, without the authorization of a majority of its voting securities. This violated Section 13(a)(3).
>
> (2) Jaquith and the members of Model, Roland & Stone served as the Fund's investment advisers without a written contract approved by a majority of the Fund's voting securities. This violated Section 15(a).
>
> (3) The Fund published, circulated and filed with the Commission various statements and reports which contained untrue statements. This violated Section 34(b)."

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[11] There is no merit to the contention of the respondents Baker and Shields (see their separate brief in opposition, pp. 4–6) that the decision below is supportable on the alternative ground (not relied on by the court of appeals) that since the complaint also states a cause of action under state law, the case is not one arising under the laws of the United States. As shown in the text, the complaint alleges violation of Sections

In addition to the foregoing violations of specific provisions of the Act, the complaint also alleged that, contrary to the declaration of policy set forth in Section 1(b)(2), the Fund was operated and managed, and its portfolio securities were selected, in the interest of directors, officers, investment advisers and other affiliated persons thereof, and in the interest of underwriters, brokers and dealers, rather than in the interest of all classes of the Fund's security holders.

The complaint further alleged (R. 2–3, 11–12) that the seven independent directors had actual or constructive knowledge of the acts charged.

Insofar as the independent directors are concerned, therefore, the complaint did not seek to hold them liable as insurers, but on the theory that they had personally and knowingly participated in the statutory violations. Whether, upon the trial of this case, the plaintiffs can establish such participation is another question. The critical point, in the present

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13(a)(3), 15(a) and 34(b) of the Act. The complaint accordingly sets forth a case under the laws of the United States, even though the same conduct may also violate state law.

This case is significantly different from *Howard* v. *Furst*, 238 F. 2d 790 (C.A. 2), certiorari denied, 353 U.S. 937, upon which these respondents principally rely. In *Howard* the court held (p. 794) that "every essential element of appellant's case depends upon" state law; and that since the charge of violation of the Securities Exchange Act of 1934 was merely a "collateral" issue, this charge did not convert the case into one arising under federal law. In the instant case, on the other hand, the violation of the Investment Company Act is the gravamen of the complaint; and such violation plainly states a case arising under the laws of the United States. The *Howard* case is discussed *supra*, n. 13, p. 37.

posture of the case, is that the complaint alleges that they did so participate, and thus asserts a liability against them based on their individual violations of the Act.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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APPENDIX

The Investment Company Act of 1940, 54 Stat. 789. 15 U.S.C. 80a-1, *et seq.*:

FINDINGS AND DECLARATION OF POLICY

SEC. 1. (a) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby found that investment companies are affected with a national public interest in that, among other things—

* * * * *

(5) the activities of such companies, extending over many States, their use of the instrumentalities of interstate commerce and the wide geographic distribution of their security holders, make difficult, if not impossible, effective State regulation of such companies in the interest of investors.

(b) * * * it is hereby declared that the national public interest and the interest of investors are adversely affected—

* * * * *

(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of

business, rather than in the interest of all classes of such companies' security holders;

* * * * *

(4) when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably distributed, or when investment companies are managed by irresponsible persons;

* * * * *

(6) when investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders;

* * * * *

It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors.

GENERAL DEFINITIONS

SEC. 2. (a) When used in this title, unless the context otherwise requires—

* * * * *

(3) "Affiliated person" of another person means

* * * * *

(D) any officer, director, partner, copartner, or employee of such other person;

* * * * *

AFFILIATIONS OF DIRECTORS

SEC. 10. (a) After one year from the effective date of this title, no registered investment company shall

have a board of directors more than 60 per centum of the members of which are persons who are investment advisers of, affiliated persons of an investment adviser of, or officers or employees of, such registered company.

CHANGES IN INVESTMENT POLICY

SEC. 13. (a) No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities—

* * * * *

(3) deviate from its policy in respect of concentration of investments in any particular industry or group of industries as recited in its registration statement, or deviate from any fundamental policy recited in its registration statement pursuant to section 8(b)(2); * * *.

INVESTMENT ADVISORY AND UNDERWRITING CONTRACTS

SEC. 15. (a) After one year from the effective date of this title it shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, unless in effect prior to March 15, 1940, has been approved by the vote of a majority of the outstanding voting securities of such registered company and—

(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of di-

rectors or by vote of a majority of the outstanding voting securities of such company;

(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser.

* * * * *

(c) In addition to the requirements of subsections (a) and (b) it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, except a written agreement which was in effect prior to March 15, 1940, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party, or (2) by the vote of a majority of the outstanding voting securities of such company.

* * * * *

TRANSACTIONS OF CERTAIN AFFILIATED PERSONS AND UNDERWRITERS

SEC. 17.

* * * * *

(h) After one year from the effective date of this title, neither the charter, certificate of incorporation, articles of association, indenture of trust, nor the by-laws of any registered investment company, nor any other instrument pursuant to which such a company is organized or administered, shall contain any pro-

vision which protects or purports to protect any director or officer of such company against any liability to the company or to its security holders to which he would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office.

* * * * *

REGISTRATION OF SECURITIES UNDER SECURITIES ACT OF 1933

SEC. 24.

* * * * *

(e) * * *

(3) For the purposes of section 11 of the Securities Act of 1933, as amended, the effective date of the latest amendment filed pursuant to this subsection or otherwise shall be deemed the effective date of the registration statement with respect to securities sold after such amendment shall have become effective. For the purposes of section 13 of the Securities Act of 1933, as amended, no such security shall be deemed to have been bona fide offered to the public prior to the effective date of the latest amendment filed pursuant to this subsection. Except to the extent the Commission otherwise provides by rules or regulations as appropriate in the public interest or for the protection of investors, no prospectus relating to a security issued by a face-amount certificate company or a redeemable security issued by an open-end management company or unit investment trust which varies for the purposes of subsection (a)(3) of section 10 of the Securities Act of 1933 from the latest prospectus filed as a part of the registration statement shall be deemed to meet the requirements of said section 10 unless filed as part of an amendment to the registration state-

ment under said Act and such amendment has become effective.[1]

DESTRUCTION AND FALSIFICATION OF REPORTS AND RECORDS

SEC. 34. * * *

(b) It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this title or the keeping of which is required pursuant to section 31(a). It shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading. * * *

RULES, REGULATIONS, AND ORDERS; GENERAL POWERS OF COMMISSION

SEC. 38.

* * * * *

(c) No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States

[1] Subsection (e) was added by Public Law No. 577, 83d Congress (68 Stat. 689).

shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. . .

* * * * *

Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. * * *

VALIDITY OF CONTRACTS

SEC. 47. (a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or with any rule, regulation, or order thereunder shall be void.

(b) Every contract made in violation of any provision of this title or of any rule, regulation, or order thereunder, and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any

person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, regulation, or order.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1961.

No. 87.

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

BRIEF

For Respondents, J. John Brouk, Jefferson J. Rebstock, Earl R. Rice, W. Munro Roberts, Jr., and James J. Mullen, Jr.

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BRIEF

For Respondents, J. John Brouk, Jefferson J. Rebstock, Earl R. Rice, W. Munro Roberts, Jr., and James J. Mullen, Jr.

INTRODUCTION.

Respondents, J. John Brouk, Jefferson J. Rebstock, Earl R. Rice, W. Munro Roberts, Jr., and James J. Mullen, Jr., constitute all of respondents except Jacob Baker and George H. Shields, III, and wherever the word "respondents" is used in this brief it will embrace the five aforenamed. Petitioner will be referred to as "Fund."

OPINIONS BELOW.

The District Court overruled motions of respondents to dismiss Fund's amended complaint for lack of jurisdiction of the subject matter and also lack of jurisdiction of the person respecting respondents, Earl R. Rice and Jefferson J. Rebstock. The District Court filed no opinion. The opinion of the Court of Appeals reversing the order of the District Court is reported at 286 F. 2d 901, and printed beginning at page 40 of the Record.

JURISDICTION.

The jurisdiction of this Court rests on 28 U. S. C. 1254 (1).

QUESTIONS PRESENTED.

Section 44 of the Investment Company Act of 1940 entitled "Jurisdiction of Offenses and Suits" creates concurrent jurisdiction in District Courts of the United States and State Courts of "all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of" the Act.

The question presented is whether the amended complaint charges facts which under the Act constitute violations of federally created statutory duties respecting directors of registered investment companies so as to give rise to a cause of action by Fund against its directors within the jurisdiction of the District Courts of the United States.

STATUTE INVOLVED.

The statute involved is the Investment Company Act of 1940. The portions relied on by petitioner are set out in the Appendix to petitioner's petition at page 61.

STATEMENT.

The type of case involved on the petition for certiorari here before this Court is a civil action for an accounting and in tort for damages brought by petitioner, Managed Funds, Incorporated, a mutual fund and registered investment company, against its investment adviser, the companies which sold its shares, its officers and directors, its New York broker and some of the broker's employees.

There is presented here only the question of federal jurisdiction respecting seven directors.

By the judgment of the United States Court of Appeals for the Eighth Circuit in Brouk et al. v. Managed Funds, Incorporated, et al. (286 F. 2d 901, R. 72), the District Court was ordered to dismiss the case as to seven former directors of Fund who attacked the Fund's amended complaint (and the Josephson complaint) by motions to dismiss for lack of federal jurisdiction of the subject matter and with respect to respondents, Jefferson J. Rebstock and Earl R. Rice, also, lack of jurisdiction of the person (R. 21-28).

On May 12, 1959, Emanuel Josephson brought a stockholder's derivative action for the benefit of Managed Funds, Incorporated, in the District Court of Delaware. This action was subsequently transferred to the District Court at St. Louis (R. 12). This complaint was adopted by intervenor, Protective Casualty Insurance Company (R. 39). On October 23, 1959 Fund filed its amended complaint in the District Court (R. 1). Only Fund appeared on the appeal heard by the Court of Appeals (286 F. 2d 901). Fund is the only petitioner here.

The judgment of the Eighth Circuit is, therefore, final respecting the complaint of Emanuel Josephson and the adoption thereof by intervenor, Protective Casualty Insurance Company. It follows that here before the Court for consideration is the amended complaint of Fund.

The identity of the parties defendant in relationship to Fund is as follows:

These respondents are five of a group of twelve former directors who are collectively described in petitioner's amended complaint as "outside directors" (R. 3).

Defendants, Hilton Slayton and Hovey Slayton, are former officers and directors of Fund. Defendant, Slayton Associates, Inc., was the investment adviser of Fund under a contract of August 15, 1952 approved by Fund's shareholders and successively renewed by the directors until April 19, 1959. Defendants, Slayton & Company, Inc., and Mutual Fund Distributors, Inc., were underwriters engaged in selling Managed Fund shares to the public. Defendant, Model, Roland & Stone, is a partnership of eleven individuals and are New York brokers (R. 3). Defendants, James S. Stubbs and Harold W. Smith, are employees of the broker partnership. Defendant, Stephen M. Jaquith, was an associate of the defendant broker partnership. None of these defendants challenged the jurisdiction of the District Court. The case is still pending in the District Court respecting the asserted liability of such defendants.

The averments respecting the outside directors are as follows:

> "On information and belief, the said outside directors, and each of them, had either actual knowledge of the acts hereinafter complained of, or, in the performance of the duties and obligations imposed upon them by law as directors, and by the exercise of ordinary care and diligence in the performance of such duties and obligations, would have acquired knowledge of such acts, and hence are chargeable with having constructive knowledge thereof" (R. 3).
>
> "Plaintiff further states, on information and belief, that the defendants committed, or with actual or con-

structive knowledge, as hereinabove set forth, aided, abetted, acquiesced in or condoned, directly or indirectly, violations of the Investment Company Act of 1940, in that, inter alia,

(a) The plaintiff was operated, managed and its portfolio securities were selected, in the interest of directors, investment advisers, and other affiliated persons thereof, and in the interest of underwriters, brokers and dealers, rather than in the interest of all classes of plaintiff's security holders (R. 6);

(b) The plaintiff was caused to publish, circulate and file with the Securities and Exchange Commission required registration statements, amendments thereto, reports and prospectuses, which documents contained untrue statements of material facts or omitted to state material facts required to be stated therein or necessary to make the statements therein not misleading (R. 7);

(c) The plaintiff was caused to deviate from a fundamental policy recited in its registration statement pursuant to Section 8 (b) (2) of the Act, without being authorized to do so by the vote of a majority of its outstanding voting securities; and

(d) Defendants Leo Model, Rolf R. Roland, Frits Markus, Robert Rosenberg, Walter H. Berton, Walter S. Morris, Frank L. Thompson and Herman H. Stone, as members of a co-partnership doing business under the name of Model, Roland & Stone, and Stephen M. Jaquith, individually, served or acted as investment advisers of the plaintiff, without a written contract approved by the vote of a majority of the outstanding voting securities of plaintiff" (R. 7).

The pleading further states:

"All of said defendants' acts were unlawful and wrongfully committed as a part of, and pursuant to, an

unlawful agreement and conspiracy between all of said defendants, except said outside directors for the purpose of unlawfully making use of the business and funds of plaintiff, to the plaintiff's damage and to the great profit of the said defendants; and said outside directors, as hereinabove set forth, had either actual or constructive knowledge of, did nothing to prevent the consummation of, and are hence chargeable with liability for, such unlawful agreement and conspiracy" (R. 11, 12).

The facts pleaded are that the adviser, Slayton Associates, Inc., was employed by Fund as investment adviser August 15, 1952, and thereafter on December 1, 1953, contracted with defendant Jaquith to act as investment counselor and manager of the securities portfolio of Fund, after which time Associates, as adviser, received fees for advisory services not performed by reason of it having unlawfully delegated its duties to Jaquith and abdicated its duties and responsibilities under its advisory contract with Fund (R. 4, 5). The 1953 contract provided Jaquith was to receive $50,000.00 per annum for five years and $35,000.00 for the succeeding five years as minimum payments to apply against brokerage commissions respecting business which the adviser, Slayton Associates, would direct to Jaquith or his designees. The broker defendants, Model, Roland & Stone, it is averred, became the designee and brokerage business was directed to them whereby they received brokerage commissions in excess of $1,500,000.00 (R. 5). The brokers are averred to have paid to defendants, Smith & Stubbs, annual brokerage commissions in excess of $50,000.00 a year. It is then averred that after Jaquith and Model, Roland & Stone furnished advisory service the Fund's basic policy of capital growth was not followed and gross mismanagement resulted. Loss and damage to the investment portfolio of Fund ensued, as well as greatly increased brokerage commissions and

greater payments under the sales contracts without any benefit to the Fund (R. 6).

Respecting Counts II, III and IV of the amended complaint Fund states (Brief p. 6):

> "The Managed Fund's complaint contains three other counts: Count II (R. 8) asserts liability for losses under the Securities Act of 1933; Count III (R. 9) bases liability for breaches of fiduciary duties; and Count IV (R. 11) seeks recovery on the claim of a conspiracy. Count III reasserts jurisdiction under the Investment Company Act, but adds that 'the unlawful and wrongful acts' constituted breaches of fiduciary duty at common law. Standing alone even without reference to the statute such counts may be joined with petitioner's statutory claim."

Thus, it is conceded these are common law counts cognizable in a Federal Court only if pendente to a federal case if one is stated by Count I.

The amended complaint presents no question respecting the regulatory provisions of the Investment Company Act and the administration of the law by the Securities and Exchange Commission. There is no averment pointing to any specific provision of the Act whereby a federally created private civil action for damages is authorized or created in favor of an investment company against its directors. The relief sought is that the actual wrongdoing defendants account and make restitution to Fund, and that Fund also recover in tort claimed damages against the outside directors who received nothing. The question is whether the amended complaint states facts regarding acts of the respondents as independent directors which are violations of duties of a federal nature having their origin in the Act so that federal jurisdiction may be implied to sustain a private action for damages.

OUTLINE OF ARGUMENT.

The decision of the court in Brouk v. Managed Funds et al., 286 F. 2d 901, that the enactments of the Investment Company Act of 1940 "do not justify implications that jurisdiction was intended to be conferred" and that the omission of provisions for private civil remedies was deliberate is amply supported by the legislative history of the Act and in accord with sound principles governing the doctrine of implied liability for asserted violations of criminal statutes.

The Investment Company Act of 1940 does not expressly or by implication impose new federal statutory standards of responsibility or new federal statutory duties respecting directors of mutual funds, the violation of which affords a basis for the application of the doctrine of implied liability and implied federal jurisdiction of private civil actions.

A. The Wagner-Lea Bill, as originally introduced, provided that directors would be required to register with the Securities and Exchange Commission, and gross misconduct and gross abuse of trust was to be made a crime so as to place upon individuals a sanction for misfeasance. These provisions were deleted and the Bill changed to make theft and conversion a crime and to authorize the Commission to enjoin directors from serving as such if guilty of gross abuse of trust. The original provisions were objected to as providing too indefinite a standard of conduct. The changes made in the Bill indicate a Congressional intent not to enter the field of director duties and liability. Hence a private civil action cannot be maintained in the federal courts.

B. The doctrine of implied liability is not applicable in situations where the application thereof requires the

courts to erect standards of responsibility for tort liability when Congress had refrained from prescribing such standards and abstained from creating private civil actions. A judicially created standard that directors should act in a "meaningful fashion"* prescribes a standard more vague than that abandoned by Congress when it enacted the legislation.

C. Federal jurisdiction must be pleaded affirmatively and distinctly.*

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* Brown v. Bullock, 194 F. Supp. 207, affirmed Second Circuit C. C. H. Fed. Sec. Law Rep. Current Par. 91045, pages 93515-93523.

ARGUMENT.

I.

A. The legislative history of the Investment Company Act.

In searching the petitioner's brief to glean from it the precise basis upon which the Fund seeks recovery from the independent director respondents, one has difficulty in discerning with precision what petitioner's contention is. It disavows any claim that an "insurer's liability" is asserted and states that it has contended all along "that it is not insurer's liability (liability without fault) which Fund seeks to impose upon respondents" (Brief 54). It says that the outside directors committed affirmative acts which were "positive breaches of their statutory duty" by renewing the advisory contract (Brief 58). Respecting the payments made to brokers, Fund says this "is not mere negligence, but gross misconduct based upon respondents' own positive acts, and when the Fund under that management performed the contract they violated the prohibitions of the statute" (Brief 58). Speaking of the violation of the stated policy, Fund says that the policy of the directors "resulted in gross 'mismanagement' to the benefit of the insiders" (Brief 58). Fund argues that even when the directors did not "directly profit by the unlawful operation, they must be held to have accepted the responsibility, powers and duties specifically imposed by the statute", and that they must "be held to respond in damages if they breach the very duties the law imposes upon them" (Brief 59). Finally, Fund summarizes in its conclusion its contention that it is entitled to recover damages from the respondents for "breach of statutory duty and violations of the Act", and that "that is why Congress made illegal the **corporate acts**

approved by these directors and created a new substantive law requiring specific corporate procedures in entering into and supervising, self dealing advisory contracts,— and imposing the penalties and sanctions of illegality and voidness, in case of any departure from these statutory procedures" (Brief p. 59).

Citing criminal cases, Fund argues a corporation can only act by its officers and directors, and that consequently when corporate acts are proscribed the sanction falls upon the individuals rather than the corporate entity whose act is made unlawful. The brief for the Securities and Exchange Commission, amicus curiae, takes a similar approach, but does not predicate the contention on criminal case authority. The argument of the Solicitor General is that although:

> "the particular statutory provisions which the respondents are alleged to have violated do not, in terms, specifically apply to directors, all the statutory prohibitions and obligations that the Act imposed upon registered investment companies necessarily also applied to the directors who governed the company. The complaint in this case, therefore, charges that the directors have breached their statutory fiduciary obligations toward the Fund by participating in the illegal acts alleged" (S. E. C. Brief 13).

Fund contends the Court in Brouk injected a false concept in mentioning "per se" liability and attributing to Fund the contention that it was asserting liability by virtue of the office of director rather than their acts. It says vicarious liability is not claimed.

There is an obvious fallacy in the foregoing contentions. The premise is that a mutual fund in corporate form can only act or be caused to act by its directors, and that a private action therefor exists in favor of share-

holders individually or "collectively, i. e., the investment company itself" (S. E. C. Brief 10) against the directors. Under this hypothesis the Fund is liable to no one, the directors to everyone. Every unlawful act becomes that of the directors, but the Act, by its terms, regulates investment companies, not directors, and such was the intent and purpose of the legislation.

As shown by the "Hearings Before a Subcommittee on Interstate and Foreign Commerce of the House of Representatives, Seventy-Sixth Congress, Third Session, on H. 10,065," the Investment Company Act of 1940 was introduced in the House March 14, 1940 by Congressman Lea as H. R. 8935, and in the Senate by Senator Wagner as S. 3580. Hearings were held before a "Subcommittee of the Committee on Banking and Currency of the United States Senate, Seventy-Sixth Congress, Third Session on S. 3580." S. 4108 was then reported out by the Senate Committee on Banking and Currency. The same Bill became H. 10,065. S. 4108 represented the results of the Senate Hearings, and involved material changes in S. 3580. The original Wagner-Lea Bill appears in Part 1 of the published reports containing "Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, Seventy-Sixth Congress, Third Session on S. 3580." Part 2 continues the published reports of the hearings. The House report respecting H. 10,065 is found in House Miscellaneous Reports, Volume 4 of the House Reports of the Seventy-Sixth Congress, Third Session, being Report No. 2639. The Senate Report appears in Senate Miscellaneous Reports, Volume 3, Seventy-Sixth Congress, Third Session, being Report No. 1775. Section 9 of the Bill as originally introduced provided in part as follows:

> "Sec. 9 (a) It shall be unlawful for any person, **unless registered under this section**, to serve or act in

any of the following capacities for a period exceeding sixty days:

(1) as officer, **director**, manager, or investment adviser of or for a registered management investment company or registered face-amount certificate company;

(2) as depositor, manager, or investment adviser of or for a registered unit investment trust;

(3) as principal underwriter for a registered open-end management investment company, registered unit investment trust, or registered face-amount certificate company; or

(4) as a distributor who makes use of the mails or any means or instrumentality of interstate commerce to engage in the business of selling periodic payment plan certificates, or as a salesman for such a distributor.

. . . . . .

(e) Any of the persons enumerated in subsection (a), and any person who presently contemplates becoming such an officer, director, manager, investment adviser, depositor, principal underwriter, distributor, or salesman may be registered under this section by filing with the Commission an application for registration. Such application shall contain such information and documents, in such form and such detail, as to such person and affiliated persons of such person as the Commission may by rules and regulations prescribe as necessary or appropriate to effectuate the purposes of this title". . . . (Page 75).*

Relevant to Section 9 was Section 17 (e) of the original Bill, which provided:

* Page references are to Part 1, Hearings S. 3580, Subcommittee of the Committee on Banking and Congress, United States Senate, Seventy-Sixth Congress, Third Session.

"(c) Any gross misconduct or gross abuse of trust in respect of a registered investment company, on the part of **any person registered under Section 9** as an affiliated person of, or principal underwriter for such company, shall be unlawful." (Part 1 Report, Page 12.)

With reference to Section 9, David Schenker, Chief Counsel, Securities and Exchange Commission, advised the Senate Committee:

"Whom do we desire to register with respect to this —an officer, director, manager, or investment adviser? Those are the people who run the company. . . . Now, the proposed recommendation of the Commission is that, in connection with any misfeasance by the officer or directors, **the sanction shall be placed upon the individuals who are guilty of the misfeasance.** Therefore, we think it is essential, and that is why we propose in our recommendation that there be registration of those who are intimately tied up with the management of the company and intimately tied up with the distribution of their securities." (Page 200.)*

At page 202,* the following discussion occurred between Senator Taft and Mr. Schenker:

"Senator Taft (interposing): I do not know of any industry where directors and officers have to register. Isn't this something new in legislation?

Mr. Schenker: Well, Senator, you take under the Securities Exchange Act of 1934, Section 15; every over-the-counter broker and dealer had to register, and it seemed to us, Senator, if Congress——

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* Page references are to Part 1, Hearings S. 3580, Subcommittee of the Committee on Banking and Congress, United States Senate, Seventy-Sixth Congress, Third Session

Senator Taft (interposing): It says any officer, director, manager, or investment adviser. The banks are more important than these, and you do not require people to register to become managers of banks or presidents or vice presidents. If you are going to do it at all, should you not begin with banks?

Mr. Schenker: On that aspect, Senator, no banks, in my opinion, would put on the board of directors any individual who did not satisfy——

Senator Taft (interposing): That is not answering my question at all. I am asking you whether there is any other industry in the world that requires registration for officers, directors, managers, and advisers of companies. Do you know of any such industry?

Mr. Schenker: Do I know of any other industry? No; Senator."

Following the foregoing a discussion occurred between Mr. Schenker, Senator Taft and Senator Wagner, joined in by Honorable Robert E. Healy, Commissioner, Securities and Exchange Commission, with respect to the form of application for registration of directors, at the conclusion of which Senator Taft said, pages 204, 205:*

"Senator Taft: My suggestion is that the approach to the regulation of investment trusts should be the same as the approach to the regulation of banks, which incidentally, have far more money to handle for stockholders and depositors than investment trusts. I suggest that periodical published statements and examinations of the investment trusts' books by a corps of bank examiners whenever they chose to walk in would be simpler than the plan proposed here. This would be sounder, I think, than the plan pro-

* Page references are to Part 1, Hearings S. 3580, Subcommittee of the Committee on Banking and Congress, United States Senate, Seventy-Sixth Congress, Third Session.

posed here, handing over to the S. E. C. the regulation of the companies **and their directors and officers**. I do not question the need of regulation, not that these revelations show the most outrageous treatment of other people's money, nor that it has been revealed by the excellent work of the S. E. C.; I do not mean to question any of that at all."

Respecting Section 17 (e), Mr. Schenker said to the Senate Committee (Page 262):*

"Mr. Schenker: Subsection (e) of section 17 attempts to set forth a broad standard of conduct.

You made a suggestion originally, Senator Taft, to this effect: Why can you not set forth in this bill a fiduciary obligation and make it a crime to violate that fiduciary obligation?

When we came to draft a provision like that it presented a great many problems, **because if you try to impose a trustee obligation on these managers, maybe that obligation is much too strict. A trustee in some instances may be liable for negligence. We felt that that was possibly too onerous an obligation to impose upon people who are managing investment companies. So we took the broader approach and said that if he was guilty of gross misconduct or gross abuse of trust, then he was guilty of a crime.**

Of course that does not mean that the Securities and Exchange Commission has the jurisdiction to determine whether he has been guilty of gross abuse of trust. That is a criminal offense, and criminal action would have to be instituted against him.

Senator Taft: There is a criminal statute which covers that, is there?

* Page references are to Part 1, Hearings S. 3580, Subcommittee of the Committee on Banking and Congress, United States Senate, Seventy Sixth Congress, Third Session

Mr. Schenker: Yes, sir; and penalties are provided for it. The penalties are referred to in section 43 on page 84 of the bill.

Senator Taft: Section 43 provides that any person who willfully violates any provision of this title or of any rule, regulation, or order hereunder shall upon conviction be fined not more than $10,000 or imprisoned not more than 2 years, or both.

That seems rather a stiff criminal provision.

Mr. Schenker: I do not think it is any different from the criminal provisions in other acts, and I think it must be read in the light of the fact that there is a special provision here which relates to violation of rules or regulations which says that the mere inadvertent violation of a rule or regulation is not sufficient to impose liability. If you read the balance of it you will find it says that no person shall be convicted under this section for the violation of any rule, regulation, or order if he proves that he had no knowledge of such rule, regulation, or order.

Senator Taft: What kind of knowledge?

Mr. Schenker: Under those circumstances, Senator, I think he would have to prove beyond a reasonable doubt——

Senator Hughes (interposing): Actual knowledge would have to be proved.

Mr. Healy: **This bill says willful violation. I do not believe constructive notice would be sufficient.**

Senator Taft: He is presumed to know the law, but the facts may be different.

Senator Wagner: It cannot be willful if he knew nothing of the law.

Senator Taft: He does not have to know the law for it to be willful. He may inadvertently do the act, but if he willfully does it and that act is a violation of the law, he has violated the law. You are pre-

sumed to know the law. You may not know the facts. If the act is willful, it is a violation of the law, a willful violation of the law.

Senator Hughes: I have never heard any such construction of 'willful' as that."

During the hearings on S. 3580, as reported in Part 2 of the Senate Reports, Arthur H. Bunker, Executive Vice-President of the Lehman Corporation, New York City, speaking of the industry's views said at page 380:

> "Now, Senator, this bill contains one provision which I probably ought to leave to the lawyers to discuss; but I would like to say just one word. Section 17 (e) says:
>
> > 'Any gross misconduct or gross abuse of trust in respect of a registered investment company . . . shall be unlawful.'
>
> Now, Senator, no one can quarrel with the general idea. Certainly, I have no word to say in favor of misconduct or abuse of trust, whether it is gross or petty; but I think you will sympathize with anyone's unwillingness to be subjected to a criminal penalty for violation of so indefinite and undefinable a prohibition."

Later on in the hearings Mr. Bunker, in summing up, stated page 1056, Part 2:

> "The obscure and indefinable provision in Section 17 regarding gross misconduct and gross abuse of trust should be eliminated."

The Senate Committee agreed with the industry objections, and Section 37 of the Act was substituted, whereby it was made a crime to steal from an investment company. The section as finally enacted provides (15 U. S. C. A.):

"80a-36. Larceny and embezzlement

Whoever steals, unlawfully abstracts, unlawfully and willfully converts to his own use or to the use of another, or embezzles any of the moneys, funds, securities, credits, property, or assets of any registered investment company shall be deemed guilty of a crime, and upon conviction thereof shall be subject to the penalties provided in section 80a-48 of this title. A judgment of conviction or acquittal on the merits under the laws of any State shall be a bar to any prosecution under this section for the same act or acts. Aug. 22, 1940, c. 686, Title I, § 37, 54 Stat. 841."

The discussion which preceded the changes was reported by Alfred Jaretzke, counsel for the closed-end companies, in the hearings which were held after the amendments were agreed to before the Subcommittee on Interstate and Foreign Commerce, House of Representatives, Seventy-Sixth Congress, Third Session, on H. 10,065, Jaretzke stating at page 124:

"The original bill contained a provision making unlawful gross misconduct and gross abuse of trust on the part of officers and directors of investment companies and consequently making such conduct subject to the penalties of the Act. The group I represent objected to this provision on the ground that it subjected persons to criminal penalty **for violation of an indefinite standard which was impossible of determination.** In arguing that this provision be eliminated from the Bill, the Securities and Exchange Commission suggested as a partial substitute therefor that larceny and embezzlement of investment companies should constitute a federal crime. It is my understanding that the record shows a number of instances of misconduct on the part of officers and directors of investment companies which would constitute larceny and embezzle-

ment and it seemed entirely appropriate to the industry that, as the Federal Government was to take jurisdiction over the industry, it should have jurisdiction to prosecute such officers. The investment companies as a body have taken the position that any provision of this kind that might tend to keep dishonest persons out of the business was salutary and in the best interests of the industry and they would certainly not wish to question a provision of this sort."

The gross abuse of trust section, originally 17 (e), became Section 36 (15 U. S. C. A. 80a-35), whereby the Commission was authorized to bring civil actions in the District Courts of the United States to enjoin an officer or director from serving or acting if such person has been "guilty" of gross misconduct or gross abuse of trust in respect of any registered investment company for which such person so serves or acts. Senate Report 1775, Senate Miscellaneous Reports, Volume 3, at page 15 of the report, describes the end results of the changes in this language:

> "Officers and directors of investment companies and certain other persons are not allowed to exculpate themselves from liability for any willful misfeasance, bad faith, gross negligence, or reckless disregard of their duties (Sec. 17). . . . Gross misconduct or abuse of trust by directors, officers, investment advisers, principal underwriters, etc., is made a basis for injunctive proceedings in a federal court to be instituted by the Commission (Sec. 36). Larceny or embezzlement of property of investment companies is made a federal crime (Sec. 37)."

It is the contention of respondents that the foregoing legislative history shows that the Commission sought from Congress a statute which would regulate investment companies by requiring registration, and also directors by

likewise requiring registration. Mr. Schenker's statement as the hearings progressed shows that the imposition of so-called trustee obligations on directors with liability for ordinary negligence was not intended. The Commission sought to fix individual responsibility on directors by Section 17 (e) providing that registered directors would be guilty of a crime for gross misconduct and gross abuse of trust. The Senate Committee was unwilling to accept such far reaching consequences to directors on a standard so nebulous as to be no standard at all. The deletion of the registration provisions for directors and the substitution of removal of officers and directors for gross misconduct indicates that Congress did not enter the field of director responsibility.

A complaint which charges by name and description the defendants who committed unlawful acts and received the illegal fruits of the scheme, and which disavows concert of action on the part of the independent directors does not state a federal case notwithstanding it is charged such directors had actual or constructive knowledge or negligently failed to discover the wrongful acts of others. The Court of Appeals in this case rightly held that the "complaints here substantially seek to hold these former directors to strict liability as insurers" (R. 71). The court had reference to Fund's contention that violation equaled liability respecting which due care is no defense,** and the weight of authority to the effect that violation of a criminal statute is negligence per se,* or creates strict liability.*

** O'Donnell v. Elgin, Joliet & Eastern Railway Company, 338 U. S. 384-395, 94 L. Ed. 187 Holding the Safety Appliance Act is a strict liability statute.

* Prosser on Torts, Second Edition, page 152, Section 34; Ezra Ripley Thayer, "Public Wrong and Private Right"; 27 Harvard Law Review 1913-14, p. 314; Clarence Morris, "The Relation of Criminal Statutes to Tort Liability; 46 Harvard Law Review 1932-3, p. 453

3. The doctrine of implied liability is not applicable.

The Fund's brief and the amicus brief of the Securities and Exchange Commission have directed attention to the federal cases wherein the Federal Courts (but not this court) have implied civil remedies and federal jurisdiction in cases under other Security Acts. The authorities are also reviewed at length in Brouk et al. v. Managed Funds, Inc., et al., 286 F. 2d 901; Brown v. Bullock, 194 F. Supp. 207 (S. D. N. Y. 1961), affirmed by the Second Circuit, September 5, 1961, not yet officially reported, C. C. H., Fed. Sec. Law Rep., Current, Par. 91046, pages 93515-93523.

Respondents recognize that the courts have developed a line of cases under the Securities Act of 1933 (15 U. S. C. A. 77a-77aa) and the Securities Exchange Act of 1934 (15 U. S. C. A. 78a-78jj), and have applied the doctrine of implied liability based on the violation of a federal statute as implying a civil action in tort, or on the ground that the statute declared certain proscribed contracts to be void. These remedies are available in purchase and sale situations, and are grounded in fraud, but not limited to common law fraud. These acts provide for civil remedies, but the courts have implied liabilities in areas not specifically within the statute. Louis Loss calls this a "surprising development," but approves the trend and believes that "the courts would be shrinking from their traditional function of supplying the lubricant for the legislative machinery if they were to hold back."* Respondents disagree, and shall undertake to show that on both reason and authority the expansion of federal jurisdiction to director cases is not indicated.

In the securities field the Brouk case and the Brown case involve the question of implied liability as related

* Vol. III, Louis Loss Securities Regulations (2d Edition, 1961), pp. 934-937, 1757-1763, 1435; Vol. II, 945.

to directors and the Investment Company Act of 1940. The court in the Brown case noted it granted a special appeal because the issue was novel and of public, as well as private importance, particularly in view of a large number of cases against directors pending in the Southern District. (Brown v. Bullock, 194 F. 2d 207, affirmed, C. C. H., Sec. Rep., Current, Par. 91046, p. 93515.)

As the authorities cited in Brouk show (R. 58) jurisdiction has been declined under many federal statutes. The reasoning against implied jurisdiction is stated by the court in a Safety Appliance Act case, Jacobson v. New York, N. H. & H. R. Co., 206 F. 2d 153, affirmed per curiam 347 U. S. 909, 98 L. Ed. 1067, as follows, l. c. 156:

> "Where there is only a criminal penalty, and no mention of any civil remedy, many courts have read into the statute a supposed or 'presumed' intent to provide one. 'In the ordinary case this is pure fiction, since the obvious conclusion is that the legislature either did not have the civil action in mind at all, or deliberately omitted to provide for it.' Prosser on Torts (1941) 265. This was squarely recognized in Gilvary v. Cuyahoga Valley Ry Co., 1934, 292 U. S. 57, 54 S. Ct. 573, 78 L. Ed. 1123. Furthermore, the Court there commented, 292 U. S. at page 61, 54 S. Ct. at page 575, that if Congress had had the purpose of creating a right of action in favor of persons not covered by the Employers' Liability Acts, 'Congress probably would have included provisions in respect of venue, jurisdiction of courts, limitations, measure of damages, and beneficiaries in case of death.'
>
> (4) But though Congress has not created a statutory right of action in favor of passengers injured as a result of violation of the Safety Appliance Acts, it is still possible for the courts to do so on principles of the common law. The breach of a penal statute

may be regarded by the courts as an operative fact upon the basis of which may be predicated a common law tort liability to a person injured as a result of the breach, provided he is within the class for whose protection the penal statute presumably was passed. The courts of the various states differ extensively in their formulation and application of the common law principle upon which a liability is created in favor of a person injured by breach of a criminal statute. Some courts speak of the breach as 'negligence per se', others as 'evidence of negligence' or as 'prima facie evidence of negligence.' Nor are they completely in agreement as to what is meant by these phrases. Furthermore, liability in such cases is fitted into whatever local variations there may be in common law doctrines as to contributory negligence, last clear chance, assumption of risk, proximate cause, etc.

The common law principle referred to in the previous paragraph was broadly stated in the leading case of Texas & Pac. Ry. Co. v. Rigsby, 1916, 241 U. S. 33, 39, 36 S. Ct. 482, 484, 60 L. Ed. 874, as follows: 'A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied, according to a doctrine of the common law * * *.' If the federal courts had undertaken to apply this principle as a matter of federal decisional law, in the case of a breach of the Safety Appliance Acts resulting in personal injury to a person not entitled to sue under the Employers' Liability Acts, and if such liability had been imposed as a matter of federal common law without reference to local variation of statutory law or of common law doctrine applicable in the state where the injury occurred, it would perhaps follow that a complaint

setting up such a liability would be a civil action arising 'under the Constitution, laws or treaties of the United States' within the meaning of 28 U. S. C. § 1331. See Reitmeister v. Reitmeister, 2 Cir., 1947, 162 F. 2d 691; Mater v. Holley, 5 Cir., 1952, 200 F. 2d 123. Cf. Odell v. Humble Oil & Ref. Co., 10 Cir., 1953, 201 F. 2d 123; Doucette v. Vincent, 1 Cir., 1952, 194 F. 2d 834, 839 et seq. See also Erie Railroad Co. v. Tompkins, 1938, 304 U. S. 64, 71-73, 58 S. Ct. 817, 82 L. Ed. 1188.

(5) But it is abundantly clear that the federal courts have not, as a matter of federal common law, developed a private right of action for damages for personal injuries resulting from a breach of the Safety Appliance Acts, in favor of persons not entitled to sue under the provisions of the Employers' Liability Acts."

Until this case this court has not been called upon to determine whether Investment Act cases are to fall within the domain of those deemed to be within or without the jurisdiction of federal courts. Charles L. B. Lowndes considers that the process of arriving at a conclusion when determining a question of implied liability involves the judicial process of interpreting the meaning of the statute rather than finding legislative intent.* As the court noted above, the courts have differed extensively in treatment of the problem of implied civil liability. Thayer suggests that confusion of thought is hidden behind "ambiguous and question begging phrases." He says, 27 Harvard Law Review 317:

"'A lucid vocabulary' as Professor Graywood has said 'is the fruitful mother of evils,' and in the present

* Civil Liability Created by Criminal Legislation, 16 Minnesota Law Review, 1931-32, p. 361

> instance the slippery word 'duty' and 'negligence' are responsible for much of the progeny. Too often the mere statement of a conclusion that 'the statute creates a duty to the plaintiff' is used as if it furnished some reasons in its own support. At times it is coupled with the further assertion that 'the plaintiff therefore has a remedy' as if this were something more than an identical proposition. In either form the question how the duty arose, and what it was that gave rise to it is left in the same darkness as before. But this is manifestly the very question at issue. In seeking the principles which determine the answer, the infinite variety of criminal statutes must be faced at the outset. The field includes the whole range of human activity, and legislative treatment must vary correspondingly."

Prosser says that "much ingenuity has been expended in the effort to explain why criminal legislation should result in civil liability" (Second Edition, p. 152). We allude to these statements of these scholars to highlight the problem and to suggest that the considerations urged by Fund are by no means decisive. Each statute must be viewed separately. Security cases under other acts do not control this case.

The Dotterweich case relied on by Fund merits discussion at this point.

United States v. Dotterweich, 320 U. S. 277, 88 L. Ed. 48, is cited by Fund to support the contention that in a misdemeanor case where only corporate conduct is proscribed **officers** are liable, and that by analogy the **directors** here should be likewise liable civilly.

The majority reviewed the history of the Act and noted that the 1906 Food and Drug Act provided that the acts of officers and agents were deemed to be the acts of the

corporation and that the 1938 amendment omitted these words. It was held that under "legal understanding" the words were superfluous and unnecessary to hold a corporation for violation. The court found no legislative intent by the deletion to hold only corporations and concluded Dotterweich, who was president and general manager, was subject to conviction for the corporation's shipment of misbranded goods in interstate commerce.

Mr. Justice Murphy wrote the dissent in which he was joined by Mr. Justice Roberts, Mr. Justice Reed and Mr. Justice Rutledge. Mr. Justice Murphy pointed out that a corporation "is not the necessary and inevitable equivalent of its officers for all purposes," and notes "a complete absence of any reference to corporate officers" (320 U. S., l. c. 287, 288). Speaking of the deletion from the Federal Food & Drug Act of the provision that "any violation of the Act by a corporation should be deemed to be the act of the officer responsible therefor, and that such officer might be punished as though it were his personal act" (l. c. 290), the minority concluded (l. c. 292):

> "We cannot presume that this omission was inadvertent on the part of Congress. United States v. Harris, supra (177 U. S. at 309, 44 L. Ed. 781, 20 S. Ct. 609). Even if it were, courts have no power to remedy so serious a defect, no matter how probable it otherwise may appear that Congress intended to include officers; 'probability is not a guide which a court, in construing a penal statute, can safely take.' United States v. Wiltberger, supra (5 Wheat. (U. S.) at 105, 5 L. Ed. 45). But the framers of the 1938 Act had an intelligent comprehension of the inadequacies of the 1906 Act and of the unsettled state of the law. They recognized the necessity of inserting clear and unmistakable language in order to impose liability on corporate officers. It is thus unreasonable to assume that the omission of such language was

due to a belief that the Act as it now stands was sufficient to impose liability on corporate officers. Such deliberate deletion is consistent only with an intent to allow such officers to remain free from criminal liability. Thus to apply the sanctions of this Act to the respondent would be contrary to the intent of Congress as expressed in the statutory language and in the legislative history.

The dangers inherent in any attempt to create liability without express Congressional intention or authorization are illustrated by this case. Without any legislative guides, we are confronted with the problem of determining precisely which officers, employees and agents of a corporation are to be subject to this Act by our fiat. To erect standards of responsibility is a difficult legislative task and the opinion of this Court admits that it is 'too treacherous' and a 'mischievous futility' for us to engage in such pursuits. But the only alternative is a blind resort to 'the good sense of prosecutors, the wise guidance of trial judges, and the ultimate judgment of juries.' Yet that situation is precisely what our constitutional system sought to avoid. Reliance on the legislature to define crimes and criminals distinguishes our form of jurisprudence from certain less desirable ones."

Like the Dotterweich case so in this case the provisions of the original bill for registration and regulation of directors were deleted prior to passage. Unlike the Dotterweich case this case involves not a president or general manager, but directors, and it cannot be said that any "legal understanding" exists which imposes on directors liability for corporate acts. The deletion left the Act with no federal duties or standards, and the duties of directors remained those at common law and as provided by the laws of the several states.

The wisdom of Congressional handling of federally created civil rights is attested by the difficulties encountered when the courts judicially imply liabilities. In the case at bar the briefs point to the sections of the Investment Company Act making unlawful advisory contracts unless approved by shareholders or annually by directors, the assignment of advisory contracts, and changing the stated policy.

In Brown v. Bullock, 194 F. Supp. 207, the District Court found implied liability under eight sections of the act, i. e., 15 (a) (3), 17 (h) and (i), 20 (a), 34 (b), 36, 37, 44 and 47 (b) relating to, respectively, stockholders' right to terminate advisory contracts, invalidity of exculpatory clauses, proxy solicitation, untrue statements, gross misconduct and gross abuse of trust, willful conversion and invalidity of contracts violating the Act. A forty-three page opinion was required to find what Congress did in a few lines in the Investment Company Act by Section 30 (f) [15 U. S. C. A. 80a 29 (f)] when it provided for the only director liability in the Act, insider trading, by saying a director was subject to the liabilities of Section 78p of the Exchange Act [15 U. S. C. A. 78 (p)]. This section says any profit realized by a director "shall inure to and be recoverable by the issuer" and "suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction." A two year limitation is provided. If the issuer fails to sue the owner of "any security of the issuer" may sue.

The Congressional approach in situations respecting federally created liabilities of directors under Securities Acts is well illustrated by the discussion of the Court of Appeals in Martin v. Hull, 92 F. 2d 208. The Court was considering director liability under the Securities Act of 1933, which expressly by its terms makes a director liable

to purchasers when a registration statement contains untrue statements. [Securities Act of 1933, § 11 (a, c). § 11 (b) (3) (c), as amended, 15 U. S. C. A., § 77k (a, c), § 77k (b) (3) (c).] Referring to the House Committee Reports the court stated, l. c. 210:

> "According to the statement of the House conferees accompanying the Conference Report on the bill, 'a point of difference between the House bill and the Senate amendment concerned the civil liability of persons responsible for the flotation of an issue. The Senate amendment imposed upon the issuer, its directors, its chief executive and financial officers, a liability which might appropriately be denominated as an insurer's liability. They were to be held liable without regard to whatever care they might have used for the accuracy of the statements made in the registration statement. The House bill, on the other hand, measured liability for these statements in terms of reasonable care, placing upon the defendants the duty, in case they were sued, of proving that they had used reasonable care to assure the accuracy of these statements. The standards by which reasonable care was exemplified was expressed in terms of a fiduciary relationship. * * * In choosing between these two standards of liability, the Senate accepted the standards imposed by the House bill.' This standard in the 1933 act is set forth in section 11 (c) (48 Stat. 82) as follows: 'In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a person occupying a fiduciary relationship.'
>
> "The standard of reasonable care was restated in the Securities Exchange Act of 1934, which amended section 11 (c) to read as follows: '(c) In determining,

for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.' [15 U. S. C. A. § 77k (c).]"

The foregoing emphasizes that when Congress enters the field of director responsibility it does so by specific language. It is mindful of the kind of liability it imposes, who may sue and the defenses to be available to directors.

The reports to which we have referred relating to the hearings respecting the Investment Company Act fail to show that at any time these questions were discussed at all.

When the Second Circuit reviewed Brown it found it "unnecessary to pass on much that was said by the District Judge or to explore other grounds of federal jurisdiction asserted by appellees and found in their favor by him—at least one of which, that based on the allegedly false or misleading proxy statements, bristles with difficulties."*

The court in its banc opinion sustained the District Court only on two grounds, the first that Section 37 of the Act (15 U. S. C. A. 80a-36) gave rise to a civil action, the court holding that the language "whoever steals, unlawfully abstracts, unlawfully and willfully converts to his own use or to the use of another, or embezzles any monies . . . of any registered investment company shall be deemed guilty of a crime" embraced a situation where it was charged that there was an unlawful and willful conversion. The court says, page 94518, that:

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* C. C. H. Fed. Sec. Ser. Current, Par. 91046, page 93516 (subsequent references to pages will be to the CCH Current Service).

> "We should think it clear that a director who had authorized corporate funds to be paid as compensation for services to a person known to him to have rendered none was guilty of knowing or willful conversion in the criminal sense."

The court concedes that to charge such a case as a basis for a civil action, it would have to be averred that the conduct of the director was willful. The amended petition of Fund in this case contains no such averment. The court also bases its holding of federal jurisdiction upon Section 15 (a) and (b) [15 U. S. C. A. 80a-15 (a) and (b)], which makes it unlawful to act as an investment adviser for more than two years unless the contract is specifically approved annually by the Board of Directors, or by a vote of the majority of the outstanding securities of the company. It holds, page 93518, that this section requires

> "not merely ceremonial performance of the act of approval, but its performance in a meaningful fashion, and that the breach of the latter requirement creates a federal claim as breach of the former unquestionably does."

The court further said:

> "We think 15 (a) and (b) laid down a requirement of annual approval not merely formal but substantial, the minimum content of which is a matter of federal law; hence a complaint alleging a failure to conform to that requirement sets forth a federal claim" (page 93519).

The court specifically announces its disagreement with Brouk.

Judge Moore dissented. The basis for his dissent is that the word "willfully," as used in the criminal section, is not to be transplanted to embrace an alleged conversion in a civil case. He disagrees with the majority that the

acts charged in the Brown complaint would support a criminal indictment. Of particular force is Judge Moore's analysis when he states (page 93522):

> "The majority say that Congress 'must have been concerned with the substance and not simply with the form.' But these words are merely abstractions **'without some standard by which to test for substance or form.'** Is a corporate resolution reading in substance that 'the services having been found to have been satisfactory, be it resolved that the contract be renewed for another year', legal or illegal? Must the state of mind of each director be explored by examination and cross-examination to ascertain as to each decision made whether 'approval was given without any real consideration of the merits.' . . .
>
> "By the decision of the majority, this case will have to go to trial. If the life spans of the case and the court happily coincide we may be able to see the beneficial effects upon society of striking 'fear of personal liability' into the minds of potential wrongdoers, thus compelling them 'to walk in the paths of rectitude'—paths to be sure which **neither Congress nor the courts have laid out with such markers as may be easily discernible by the pedestrian director.** There should be more constitutional methods of permitting every stockholder to be a Sir Galahad than this in terrorem approach."

The striking from the original bill Section 17 (c) with its lack of a standard respecting gross abuse of trust as a crime supports Judge Moore's conclusion and the contention of respondents that the amended complaint does not state a federal case.

The District Court in Brown had determined that a civil action would lie by implication for conduct by a director constituting "gross misconduct or gross abuse of trust"

relying on Section 36 providing for injunction in such cases. Here again Fund's amended complaint does not attempt to plead a case based on gross misconduct and gross abuse of trust. The acts described insofar as they relate to the respondents here, the independent directors, when viewed in light of the specific averments of negligence, constructive knowledge, etc., do not constitute averments of the violation of Section 36 as a basis for liability on the part of respondents. Respondents, however, contend that the District Court in Brown was in error in the holding that Section 36 gives rise to an implied civil action. It is limited to injunctive proceedings at the behest of the Commission.

C. **Federal jurisdiction must be pleaded affirmatively and distinctly.**

Respondents agree with petitioners and the accepted rule announced by this court that the Federal Rules permit notice of pleading and complaints are not to be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts which would entitle plaintiff to relief. Equally well settled by this court is the requirement that jurisdiction must affirmatively appear. The principle is stated in Thomas v. Ohio State University Trustees, 195 U. S. 207, 25 S. Ct. 24, 49 L. Ed. 160, l. c. 163, as follows:

> "That the jurisdiction of a circuit court of the United States is limited in the sense that it has no jurisdiction except that conferred by the Constitution and laws of the United States; that a cause is presumed to be without its jurisdiction unless the contrary affirmatively appears; that such jurisdiction, or the facts upon which, in legal intendment, it rests, must be distinctly and positively averred in the pleadings, or should appear affirmatively and with equal distinctness in other parts of the record, it not being sufficient that

> jurisdiction may be inferred argumentatively; and that, for the purposes of suing and being sued in a circuit court of the United States, the members of a local 'corporation' are conclusively presumed to be citizens of the state by whose laws it was created, and in which alone the corporate body has a legal existence—are propositions so firmly established that further discussion of them would be both useless and inappropriate."

The pleader must point not just to a federal statute, but to a federal statute creating federal duties and rights of action in Federal Courts. This, respondents assert, petitioner has failed to do.

CONCLUSION.

This record does not present a case where a decision by this court declining federal jurisdiction will defeat the purposes of the Act and leave shareholders or Fund without a remedy. The state courts are open and by the Act have jurisdiction. State law will govern the duty of directors, statutes of limitation, negligence, degrees of care, breach of fiduciary obligations, good faith, contribution, indemnity and all the aspects of this type of litigation, none of which have received Congressional attention in the Investment Company Act. The amended complaint pleads only a state court mismanagement case and attempts to charge violations of the Federal Act to create a spurious case of federal jurisdiction so as to invoke the "long arm" service statute and bring respondent Rice from Florida and respondent Rebstock from Louisiana into the District Court of Missouri. Federal jurisdiction, choice of forum and long arm service must stem from a federal case.

The decision of the Court of Appeals ordering dismissal of Fund's amended complaint as to the respondent direc-

tors should be affirmed. There is no occasion for this court to start the evolution of a body of federal law.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1961.

No. 87.

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

BRIEF

For Respondents, Jacob Baker and George H. Shields, III.

In lieu of filing a separate brief on the merits, Respondents Baker and Shields respectfully:

1. Adopt the brief on the merits being filed for Respondents J. John Brouk et al., and

2. Request the Court to consider the argume
in the "Brief in Opposition" (blue cover) f
Respondents Baker and Shields.

Respectfully submitted,

WILLIAM STIX,
Attorney for Respond
Baker and Shields.

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506 Olive Street,
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SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
MAR 30 1962
JOHN F. DAVIS, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1961.

No. 87.

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

SUGGESTION THAT THE ABOVE CAUSE HAS BECOME MOOT AND JOINT MOTION OF PETITIONER, MANAGED FUNDS, INCORPORATED, AND RESPONDENTS TO VACATE AND REMAND.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1961.

No. 87.

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

SUGGESTION THAT THE ABOVE CAUSE HAS BECOME MOOT AND JOINT MOTION OF PETITIONER, MANAGED FUNDS, INCORPORATED, AND RESPONDENTS TO VACATE AND REMAND.

Come now Petitioner, Managed Funds, Incorporated, and Respondents J. John Brouk, Jefferson J. Rebstock, Earl R. Rice, W. Munro Roberts, Jr., and James J. Mullen, Jr., Jacob Baker and George H. Shields, III, and respectfully move this Court for an order vacating the judgment of the United States Court of Appeals for the Eighth Circuit and remanding this cause to the United States District Court for the Eastern District of Missouri, Eastern Division, with instructions to dismiss the Respondents from this Cause, for the reason that the controversy involved

between Petitioner and Respondents has become moot by reason of the settlements hereinafter set forth between Petitioner and Respondents (and others) after trial, and after decision and judgment in the Chancery Court of the State of Delaware, in a companion case, approving the principal settlement ($950,000.00) and holding that court approval of the supplemental settlement, involving these respondents ($100,000.00), to be unnecessary.

1. **Issue Before This Court.** This cause is before this Court on a writ of certiorari to the Court of Appeals for the Eighth Circuit. The said Court of Appeals, in an interlocutory appeal under 28 U. S. C. A., Section 1292 (b), reversed an order of the United States District Court for the Eastern District of Missouri overruling Respondents' motions to dismiss the Respondents for lack of Federal jurisdiction.

2. **Brief Statement of Grounds for This Motion.** As grounds for this motion, Petitioner sets forth below in detail, the facts regarding the litigation, pending in three courts in this case, showing (in brief): that all the principal issues in the case, now pending in the United States District Court below, were tried, submitted and decided by the Chancery Court of the State of Delaware as to parties there sued; that in that case—originally a stockholder's derivative suit,—Petitioner, Managed Funds, Inc. was given and assumed primary responsibility and control of the trial and briefing of the case; that the Court determined that the total joint and several liability of each class of defendants (hereinafter set forth in detail) amounted to the sum of $1,217,997.79; (b) that thereafter, before entry of judgment, settlement with certain Broker Defendants for the sum of $950,000.00 was duly approved by said Court after due notice to shareholders; (c) that thereafter judgment was entered for the balance of said liability, $267,997.79, against the non-settling defend-

ants therein (including one of the Respondent Directors and against the sequestrated property of another Respondent Director, who did not appear generally in said Delaware Court); that thereafter the liability of all of the Directors (including Respondents but not including Hilton H. Slayton and Hovey E. Slayton) was thereupon settled for the sum of $100,000.00, reserving all rights against the "Slayton defendants", hereinafter mentioned; that the said Delaware Chancery Court held that approval of the said settlement with the said Directors was not required, for the reason that Petitioner had been charged with primary responsibility and control of the said litigation and had prosecuted the case to judgment, and was in the control of an independent Board of Directors; that said settlement was thereupon consummated, with the stipulation that the Petitioner and the Respondents, who were parties to said supplemental settlement for $100,000.00, would jointly apply to this Court suggesting that the case was moot, moving for vacation of judgment of the Court of Appeals for the Eighth Circuit and remanding to the District Court for action consistent with settlement.

For the information of the Court, the details of the circumstances above set forth and in support of this motion are stated as follows:

3. **The Litigation Relevant to This Motion.** This litigation followed publicity which was given to an investigation of this mutual fund by the Securities Exchange Commission in May, 1959, reported in CCH Fed. Sec. L. Rep., 1957-1961 Decisions, Para. 76,662, p. 80,504, issued on July 30, 1959. Three principal cases were filed, on the same state of facts, as follows:

(a) Petitioner, Managed Funds, Inc. in May, 1959, instituted the present action in the United States District Court for the Eastern District of Missouri at St. Louis, Missouri, styled in that court, **Managed Funds, Incor-**

porated v. Slayton Associates et al., No. 59C 162, against certain of its former directors, its advisers, underwriters and brokers. This case did not come to trial and is pending, upon certiorari, in this Court as **Managed Funds, Inc. v. Brouk** et al. The respondent directors herein were not originally joined but in October, 1959, they were named as defendants in an amended complaint. This amendment occasioned withdrawal of original counsel, and shortly thereafter, prosecution of all the litigation was taken over by present counsel.

(b) The principal derivative stockholder's suit (tried on the merits) was instituted in the same month (May, 1959) on behalf of Petitioner in the Court of Chancery of the State of Delaware, in and for the County of New Castle, styled **Lutz v. Boas** et al., Cause No. 1147, alleging the same causes of action against certain of the same defendants named in the aforementioned cause. Subsequently, upon appearance and application of the undersigned counsel for Managed Funds, Inc., in December, 1959, Petitioner, Managed Funds, Inc. was realigned in said cause as a party plaintiff, and upon accession of new and independent management, the corporation was given "primary control and responsibility" for the conduct of that case in April, 1960, before trial.

(c) A derivative stockholder's suit, **Josephson v. Slayton**, et al., No. 59 C 273 (3), had been filed, in the same month of May, in the United States District Court for the District of Delaware, alleging the same causes of action against certain of the defendants named in the two aforementioned causes. **Josephson v. Slayton** et al., was then transferred to the United States District Court in St. Louis and remained dormant until Nov. 13, 1959 when a petition to intervene was filed in said cause by another stockholder, Protective Casualty Insurance Company, and on January 29, 1960, Protective Casualty, the intervening

stockholder, was granted leave to intervene and to file an amended complaint. Said cause was consolidated with **Managed Funds v. Slayton Associates** et al., by order of Court, dated 11th day of March, 1960. The motions of Respondents to dismiss, mentioned in paragraphs 1 and 6 hereof were filed in these consolidated causes.

Counsel for **Managed Funds, Inc.** argued and briefed Respondents' motions in the trial court, and upon interlocutory appeal, and prosecuted all proceedings and filed all briefs in this Court, upon certiorari.

4. There were three "classes" or "groups" of defendants in each of the three aforementioned causes and different defendants within each of these three groups were served or appeared in each of the cases: (1) Hilton H. Slayton, Hovey E. Slayton and the advisory and underwriting companies which they controlled (referred to herein as "Slayton Defendants"), (2) the brokerage firm of Model, Roland & Stone, its partners, and certain of its associates (referred to herein as "Broker Defendants"), and (3) certain of Petitioner's former directors (referred to herein as "Directors").

5. The following tabulation shows, graphically, all defendants who were joined and who appeared generally or specially or were served by process, or sequestration of property, in each of the above-mentioned cases:

United States District Court — St. Louis, Mo.		Delaware Chancery Court, Wilmington, Del.
(Managed Funds, Incorporated, vs. Slayton Associates, Inc.	Jaeroheon vs. Slayton et al., Protective Casualty Co., Intervenor	Lutz (Brockenridge, Her Executor, by Substitution) vs. Boas et al.
(Managed Funds, Incorporated vs. Brouk et al. in This Court)		
Slayton Defendants:		
Hilton H. Slayton	Hilton H. Slayton	Hilton H. Slayton
Hovey E. Slayton	Hovey E. Slayton	Hovey E. Slayton
Slayton Associates, Inc.	Slayton Associates, Inc.	Slayton Associates, Inc.
Slayton & Co., Inc.	Slayton & Co., Inc.	.....
Mutual Fund Distributors, Inc.	Mutual Fund Distributors, Inc.	.....
Broker Defendants:		
Model, Roland & Stone	Model, Roland & Stone	Model, Roland & Stone
Leo Model	Leo Model	Leo Model
Rolf R. Roland	Rolf R. Roland	Rolf R. Roland
Frits Markus	Frits Markus	Frits Markus
Robert Rosenberg	Robert Rosenberg	Robert Rosenberg
Walter H. Berton	Walter H. Berton	Walter H. Berton
Walter S. Morris	Walter S. Morris	Walter S. Morris
Erwin Wolff	Erwin Wolff	Erwin Wolff
Herman E. Stone	Herman E. Stone	Herman E. Stone
Elliot D. Fox	Elliot D. Fox	.....
Frank L. Thompson	Frank L. Thompson	.....
Stephen M. Jaquith	Stephen M. Jaquith	.....
Harold W. Smith	Harold W. Smith	.....
James S. Stubbs	James S. Stubbs	.....
Directors:		
Earl R. Rice	Earl R. Rice	Earl R. Rice
Jefferson J. Rebstock	Jefferson J. Rebstock	Jefferson J. Rebstock (only to extent of property sequestered)
J. John Brouk	J. John Brouk	.....
James J. Mullen Jr.	James J. Mullen Jr.	.....
W. Munro Roberts, Jr.	W. Munro Roberts, Jr.	.....
Lloyd E. Boas	Lloyd E. Boas	.....
Robert A. Hicks	Robert A. Hicks	.....
George H. Shields, III	.....	.....
Edwin J. Cunningham	.....	.....
Charles E. Brown	.....	.....
Jacob Baker	.....	.....

6. There was no diversity of citizenship as to the defendants in the action brought in the United States Courts and the basis for federal jurisdiction was that the complaint stated a cause of action under the Investment Company Act of 1940. The Directors (with the exception of Lloyd E. Boas who filed an answer), appeared specially and filed motions to dismiss the complaints, because of the lack of federal jurisdiction, asserting the jurisdictional question involved in this petition for certiorari: that the

Investment Company Act of 1940 did not create any statutory duties, violation of which gives rise to a private right of action in favor of a mutual fund against its former directors. The said District Court in St. Louis entered an order overruling said motions, but drafted its order to conform to the requirements of 28 U. S. C. A., Section 1292 (b), relating to interlocutory appeals, and said order also provided that "if appeal is permitted, the proceedings herein are stayed until further order". Thereafter, the United States Court of Appeals for the Eighth Circuit permitted the interlocutory appeal under Section 1292 (b), and, on appeal, the case was briefed and argued by Petitioner, Managed Funds, Inc., and Respondents. On January 13, 1961, the said Court of Appeals reversed the order of the District Court overruling said motions to dismiss, and adjudged that the appealing directors be dismissed for lack of federal jurisdiction, sustaining Respondents' contention that the Investment Company Act of 1940 did not impose any duties upon directors of a mutual fund, a breach of which would give rise to a private right of action by a mutual fund against its directors.

7. Subsequently Managed Funds petitioned this Court for a writ of certiorari in **Brouk v. Managed Funds, Inc.**, and pending a ruling on said petition the mandate of the United States Court of Appeals for the Eighth Circuit was stayed by the latter Court. Thereafter, a writ of certiorari was granted by this Court, briefs have been filed by Petitioner and Respondents and the matter is now pending in this Court awaiting oral argument.

8. **The Trial and Separate Settlement with the Broker Defendants in Delaware.** In the meantime (February to May 1960), Petitioner, Managed Funds, Inc., proceeded with preparation of the Delaware case, which was set for early trial, and where there were no jurisdictional questions. The Delaware case, **Lutz v. Boas, et al.**, was tried by Petitioner and the Broker Defendants and

Directors before that Court, and submitted to the Chancery Court on a voluminous record including depositions of almost all of the aforementioned defendants in the three cases, hundreds of exhibits and oral testimony adduced before the Court, on the trial of that cause beginning May 16, 1960. Thereafter, extensive briefs were prepared and filed over the following six months by the Petitioner and by the Defendants appearing in that cause. The cause was argued in the said Chancery Court on November 28, 1960.

The said Chancery Court rendered its decision on the merits on May 25, 1961, in favor of Managed Funds, Inc., holding that the defendants, who were there served or appeared, were jointly and severally liable to Managed Funds (reported in 171 A. 2d 381). The entry of judgment was postponed pending computations from the record of the dollar amount of the liability as found by the Court. A hearing on such "matters undetermined" was set for October 9, 1961 and a supplemental opinion was issued, dated November 10, 1961, reported in 176 A. 2d 853.

On September 22, 1961, prior to the actual entry of judgment in **Lutz v. Boas** et al., Managed Funds and the Broker Defendants entered into a stipulation for a separate settlement for the sum of $950,000.00. (The total liability of the defendants in the said Delaware cause was later determined to be $1,217,997.79). After due notice to stockholders, and with no stockholders appearing to object, the Court of Chancery on November 21, 1961, approved the stipulation of separate settlement between Managed Funds and the Broker Defendants. Also, on November 21, 1961, judgment was entered by said Chancery Court, confirming approval of the settlement and dismissing the Broker Defendants, who were in court, with prejudice. Judgment was also entered against the Slayton defendants there sued, defendant Earl R. Rice and defendant Jefferson J. Rebstock to the extent of his property sequestered (after crediting their liability with the pro-

ceeds of the settlement) for the sum of $267,997.79 (with interest of $322,644.20 against the Slayton defendants). The Chancery Court reserved jurisdiction to consummate the settlement and to enforce plaintiff's rights against all defendants over which it had jurisdiction in said cause. Defendant Earl R. Rice (a Respondent here), took an appeal to the Supreme Court of Delaware.

9. **Dismissal of Broker Defendants in St. Louis Federal Court as a Condition of Settlement.** The Delaware stipulation of separate settlement with the Broker Defendants provided that the sum of $950,000.00 would be deposited in the Registry of the Delaware Chancery Court and that said sum should be released to Petitioner unconditionally upon Petitioner filing with said Chancery Court a certified copy of an order of the United States District Court in St. Louis dismissing the consolidated actions pending there with prejudice and without costs as against the Broker Defendants. The stipulation provided further that if such an order was not filed within sixty days after November 21, 1961, the said sum of $950,000.00 was to be returned to the Broker Defendants, and judgment in the full amount was in such case to be reinstated against the Broker Defendants before the Delaware Court in accordance with the said decision and findings of the said Delaware Court.

10. **Frustration of Settlement With Broker Defendants.** On November 30, 1961, and thereafter, the Broker Defendants and Managed Funds, Inc. moved in the United States District Court in St. Louis to modify the above-mentioned stay order entered by the said District Court in St. Louis at the time the interlocutory appeal was taken, for the purpose of permitting Managed Funds and the Broker Defendants to obtain a dismissal of the Broker Defendants as required by the stipulation of separate settlement. The Directors, including the Respondents herein, objected to these motions on the grounds that their rights, including

their right to assert cross claims for indemnity against the Broker Defendants in the District Court in St. Louis, would be prejudiced if, prior to a ruling by this Court on the jurisdictional issues now before it, the Broker Defendants were dismissed from the causes pending in the said District Court. Thereafter, on January 11, 1962, the said motions to modify or set aside the stay order were denied.

11. **Application in Delaware to Vacate Settlement With Broker Defendants.** Managed Funds upon failure of the settlement with the Broker Defendants, then filed a motion in the said Chancery Court in Delaware to vacate and modify the judgment of November 21, 1961, for failure to consummate the settlement, praying for entry or reinstatement of the judgment against the Broker Defendants before the Court, in the full amount, in accordance with the Court's decision and findings as provided in the said stipulation of separate settlement, and further praying that the Court modify or enter a new judgment against the other defendants in said cause for the full amount of their liability (for the reason that prior to entry of judgment against them, their total liability for damages had been credited with the amount of the settlement proceeds.)

12. **The Settlement With Directors, Making This Appeal Moot After Waiver by Broker Defendants of Order of Dismissal in Federal Court.** The Broker Defendants and Respondents then offered to consummate the settlement with waiver by the Broker's of the requirement of such dismissal in the St. Louis actions, if Managed Funds would agree to accept $100,000.00 in settlement of its claims against all said Directors, said joint offer including the requirement that mutual releases be exchanged so as to settle all questions of cross-claims between the defendants for indemnity or contribution. Thereupon, on January 19, 1962, just prior to the hearing on application to reinstate

the judgment in Delaware, a second stipulation was entered into by and on behalf of Managed Funds, the Broker Defendants and, also the Directors (including the Respondents herein) which also amended or modified the original stipulation of separate settlement between the Broker Defendants and Petitioner so as to waive such dismissal in the St. Louis District Court. A copy of said stipulation of January 19, 1962, is hereto annexed as Appendix A. In such January 19, 1962, stipulation, the Broker Defendants agreed to waive unconditionally the requirements contained in their stipulation of September 22, 1961, that they be dismissed with prejudice from the causes pending in the United States District Court in St. Louis, and, Managed Funds, Inc. agreed to accept in compromise and settlement of all its claims against the Directors, including Respondents herein (all of whom denied liability), the additional sum of $100,000.00, reserving its rights against the Slayton Defendants. The said stipulation also provided that Director-Respondent Earl R. Rice dismiss his appeal to the Supreme Court of Delaware and that Managed Funds, Inc. would join with the Respondents herein in a motion before this Court suggesting the settlement of January 19, 1962, with the Directors, including Respondents, that the controversy involved and presently pending before this Court had become moot and praying for an order of this Court vacating the judgment of the Court of Appeals for the Eighth Circuit and remanding the case to the District Court in St. Louis with directions for further appropriate proceedings consistent with the settlement. The Securities and Exchange Commission, Amicus Curiae, was kept advised of the said settlement negotiations and of said stipulation of January 19, 1962.

Thereupon, the $950,000.00 held by the Register in Chancery was unconditionally released to Managed Funds, and Managed Funds also has now received from Directors, in-

cluding the Respondents herein and other defendants, an additional sum of $100,000.00 as provided in the said January 19th stipulation. Pursuant thereto, Managed Funds, Inc., the Broker Defendants and the Directors (except Hilton H. and Hovey E. Slayton), have exchanged mutual covenants not to sue or releases, and Respondent Earl R. Rice has dismissed his appeal in Delaware. In connection with orders releasing funds of Defendant Directors Rice and Rebstock from seizure and sequestration, pursuant to settlement, the Delaware Chancery court ruled, as above stated, that it was not necessary that Petitioner's said settlement with the Directors be submitted to the Delaware Court for its approval.

13. By reason of the aforesaid settlement with the Directors, including Respondents herein, all the claims of Petitioner, Managed Funds, Inc., against the Directors, including Respondents herein, have been settled and compromised, and accordingly, all controversies involved in the proceeding presently pending before this Court have become moot.

14. Petitioner is advised and respectfully submits that under the decisions of this Court the proper procedure to be followed when a case pending in this Court becomes moot by settlement is as herein prayed, namely, the entry of an order vacating the judgment of the Circuit Court of Appeals and remanding the cause to the lower court with directions for dismissal of Respondents. A memorandum of authorities is hereto attached as Appendix B.

Wherefore, Petitioner respectfully prays the Court that it enter its order finding that the controversy between Petitioner and Respondents has become moot, vacating the judgment of the Court of Appeals for the Eighth Circuit and remanding the case to the United States District Court for the Eastern Division of the Eastern District of

Missouri for dismissal of Respondents and such further action as said Court may deem proper.

Respectfully submitted,

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APPENDIX "A."

In the Court of Chancery of the State of Delaware in and for New Castle County.

Hunter Breckenridge, Executor u/w Nettie M. Lutz, Deceased, and Managed Funds, Inc., Plaintiffs, vs. Lloyd E. Boas et al., Defendants.	Civil Action. No. 1147.

In the United States District Court for the Eastern District of Missouri, Eastern Division.

Managed Funds, Inc., Plaintiff, vs. Slayton Associates, a Corporation, et al., Defendants.	No. 59 C 162 (3).
Emanuel Josephson, Plaintiff, Protective Casualty Ins. Co., Intervenor-Plaintiff, vs. Hilton H. Slayton et al., Defendants.	No. 59 C 279 (3).

Stipulation.

It is stipulated and agreed by and between the undersigned parties by their attorneys as follows:

(1) That upon hearing before the Delaware Chancellor for vacation of present judgment, the attorneys for the Model defendants as heretofore defined will acknowledge

performance by Managed Funds, Inc., of paragraph 1 of the stipulation in settlement, waiving compliance with the said provision of said stipulation requiring the filing of an order or judgment of dismissal in the causes mentioned therein, pending in the United States District Court in St. Louis, without prejudice to Model defendant's right to hereafter apply in said St. Louis cases for such dismissal with prejudice as to the settling defendants as defined therein, and the Model defendants will consent to an order by the Chancellor releasing the $950,000 on deposit with the Register unconditionally to plaintiff Managed Funds, without regard to consummation of settlement mentioned below in paragraph 2 hereof, and thereupon judgment heretofore entered on November 21, 1961, shall remain in full force and effect, subject to rights of appeal if any by remaining defendants therein, or by plaintiffs except as to dismissal as to Model defendants.

(2) That plaintiff Managed Funds and plaintiff Breckenridge, Executor u/w Nettie M. Lutz, stipulate and agree, subject to approval of the Chancery Court in Delaware (if such approval shall be deemed necessary by any defendant to be dismissed hereunder, or by either of said plaintiffs or by the Court) to accept in settlement of the liability of all former directors of Managed Funds, Inc. (except Hilton H. and Hovey E. Slayton and Lloyd Boas), who are defendants in this cause or in said causes in United States District Court in St. Louis, the sum of $100,000; and certain of the defendants in this action and in the St. Louis actions have agreed to pay (in amounts agreed to by them among themselves) said sum of $100,000 in settlement of said liability; and that upon payment of said sum to Managed Funds, together with delivery to Managed Funds, Inc., and to the Model defendants and their settling associates of releases executed by each of said directors, with the exceptions noted, of all claims of every kind and character then existing against said Man-

aged Funds, Inc., and said Model defendants respectively, Managed Funds, Inc., and said Model defendants, shall deliver to the same defendant directors covenants not to sue or levy execution against them, or releases, reserving all rights of said Managed Funds, Inc., against the defendants, Hilton H. Slayton, Hovey E. Slayton, Slayton Associates, Inc., Slayton & Co., Inc., and Mutual Fund Distributors (hereinafter referred to as the Slayton defendants) and against Lloyd E. Boas, said sum to be recited as the consideration for said covenants or releases and to be credited against the above-mentioned judgment to be entered in the Chancery Court in Delaware; and plaintiffs, in consideration of said settlement shall consent to and concur in such action as shall be appropriate in connection with the same to release from sequestration or seizure any funds of defendant Rice held by Managed Funds against said judgment to the parties entitled thereto, and also funds sequestered or held, of Jefferson J. Rebstock, subject to the said judgment, reserving all rights of plaintiff against said Slayton defendants and Lloyd E. Boas. Defendant Rice shall thereupon dismiss his appeal, if any, in the Supreme Court of Delaware. Managed Funds, Inc., stipulates and agrees that as advised by counsel and at the request of the Model defendants, it will give such assistance and execute such applications, stipulations, or other documents as may be necessary or appropriate, to effect the dismissal of the St. Louis actions as against all defendants, other than the Slayton defendants and said Boas.

(3) That after consummation of said settlement aforesaid in connection with the action in the Delaware Chancery Court, Plaintiff will prepare and submit jointly with Respondents therein, an application to the Supreme Court of United States suggesting this settlement and that the case has therefore become moot, and praying for an order vacating the judgment of the Court of Appeals for the

Eighth Circuit and remanding the cause to the United States District Court for the Eastern Division of the Eastern Judicial District of Missouri for further appropriate proceedings consistent with settlement.

This stipulation may be signed in separate counterparts.

Approved:

John Vanbrunt,
Attorneys for Directors, Mullen, Brouk, Rice, Rebstock and Roberts.

Richard L. McMahon,
Attorney for Managed Funds, Inc.

William E. Taylor, Jr.,
Attorney for Plaintiff Breckenridge.

John Vanbrunt,
Attorney for Defendant Rice.

Robert H. Richards, Jr.,
Attorney for Model, Roland & Stone and Settling Defendants.

APPENDIX "B"

In the
Supreme Court of the United States,
October Term, 1961.
No. 87.

Managed Funds, Incorporated,
Petitioner

vs.

J. John Brouk, et al.,
Respondents.

Memorandum of Authorities on Procedure.

This cause is presently pending before this Court, upon certiorari, to review a holding of the Court of Appeals for the Eighth Circuit that there was no Federal jurisdiction over the subject matter of Petitioner's claim against the Respondent Directors, because the Investment Company Act of 1940 did not create any statutory duty, violation of which would give rise to such claims.

As pointed out in the foregoing suggestion and joint motion, the Petitioner and Respondents entered into a settlement while this matter was pending before this Court, rendering moot the issues involved in this proceeding. We have not found any precedents of this Court on this subject dealing directly with an interlocutory appeal by only part of the defendants below,—i. e., where the cause becomes moot by reason of partial settlement with some of the defendants,—including those involved in the appeal leaving the action pending below against other defendants.

The principles announced in the cases are, however, clearly defined and can be applied to the circumstances

here presented: It seems to be well-established by a long line of decisions of this Court (a) that when a cause pending before this Court becomes moot, proceedings on the merits should not be had here or in any court below; and (b) that this Court should dispose of the entire case,—not merely of the appellate proceedings which brought it to this Court,—by reversing or vacating the mandates or judgments of all the courts below, and remanding the cause for dismissal of the complaint on the ground that the case is moot. **Securities & Exchange Commission v. Lea Fabrics, Inc.**, 363 U. S. 417, 4 L. Ed. 2d 1515, 80 S. Ct. 1258 (1960); **McGrath v. National Association of Manufacturers**, 344 U. S. 804, 97 L. Ed. 627, 73 S. Ct. 31 (1952); **Snyder v. Buck**, 340 U. S. 15, 95 L. Ed. 15, 71 S. Ct. 93 (1950); **U. S. v. Munsingwear, Inc.**, 340 U. S. 36, 95 L. Ed. 36, 71 S. Ct. 104 (1950); **Duke Power Co. v. Greenwood County**, 299 U. S. 259, 81 L. Ed. 178, 57 S. Ct. 202 (1936); **U. S. v. Anchor Coal Co.**, 279 U. S. 812, 73 L. Ed. 971, 49 S. Ct. 262 (1928); **Berry v. Davis**, 242 U. S. 468, 61 L. Ed. 441, 37 S. Ct. 208 (1916); **Brownlow v. Schwartz**, 261 U. S. 216, 67 L. Ed. 620, 43 S. Ct. 263 (1922); **Alejandrino v. Quezon**, 271 U. S. 528, 70 L. Ed. 1071, 46 S. Ct. 600 (1925); **U. S. ex rel. Norwegian Nitrogen Products Co. v. U. S. Tariff Commission**, 274 U. S. 106, 71 L. Ed. 949, 47 S. Ct. 499 (1926); **Board of Pub. Util. Comm. v. Compania General De Tabacos De Filipinas**, 249 U. S. 425, 63 L. Ed. 687, 39 Sup. Ct. 332 (1918); **Commercial Cable Co. v. Burleson**, 250 U. S. 360, 63 L. Ed. 1030, 39 S. Ct. 512 (1918); **U. S. v. Hamburg-Amerikanische Packet-Fahrt-Actien Gesellschaft**, 239 U. S. 466, 60 L. Ed 387, 36 S. Ct. 212 (1915).

The "entire case" referred to in the language of this Court appears to mean the case in **all courts**,—from the trial court through the appellate courts. While here the "entire" case is not disposed of as to all **defendants**, a definitive settlement with part of the defendants requires

disposal of that part of the case in all courts,—not just this Court.

In **Alejandrino v. Quezon,** supra, a Senator of the Philippine Islands Senate sought the issuance of a preliminary injunction and a writ of mandamus to restrain the Senate from depriving him of his rights as a Senator for a period of one year and to compel the Senate to recognize him as a Senator. The Supreme Court of the Philippine Islands, as did the Court of Appeals in this cause, held that there was no jurisdiction in that court. A petition for certiorari was granted by this court, but while the matter was pending here, the one year period had elapsed and the issues involved were moot. This court in disposing of the matter, stated:

> ". . . further steps looking to an adjudication of the cause can neither be had here nor in the court below. In this situation we must, following the established practice of this court, vacate the judgment below and remand the cause with direction to dismiss the petition. . . ." 271 U. S. 535-536, 70 L. Ed. 1074.

In **U. S. v. Anchor Coal Co.,** supra, the parties entered into a settlement while the matter was pending before this Court (see 6 Moore Federal Practice, pp. 3072-3073, Fn. 5). This Court in disposing of the matter stated:

> "These appeals have been fully argued and considered, but in the present situation we find that they present moot issues, and that further proceedings upon the merits can neither be had here nor in the court of first instance. To dismiss the appeals would leave the injunction in force, at least apparently so, notwithstanding that the basis therefor has disappeared. Our action must, therefore, dispose of the cause, not merely of the appellate proceedings which brought it here. The practice now established by this

Court under similar conditions and circumstances is to reverse the decree below and remand the cause with directions to dismiss the bill. The order will be, therefore, that the decree is reversed, with directions to the District Court to dismiss the bill of complaint without costs, because the controversy involved has become moot, and is therefore no longer a subject appropriate for judicial action (Citing cases)."

The purpose of the order prayed is therefore two-fold: to preclude any judicial action on the merits of the controversy in this Court; and second to vacate the action thereon, of all courts below.

Respectfully submitted,

R. WALSTON CHUBB,
ROBERT S. ALLEN,
DOMINIC TROIANI,
611 Olive Street,
St. Louis (1), Missouri,
Attorneys for Petitioner.

CERTIFICATE OF SERVICE.

City of St. Louis, } ss.
State of Missouri. }

R. Walston Chubb, attorney for the Petitioner in the above-entitled cause, upon his oath states that a true copy of the foregoing motion and appendices annexed thereto was served upon the Solicitor General of the United States, Counsel for Securities and Exchange Commission, Amicus Curiae, and upon said Securities and Exchange Commission, whose acknowledgements of service are hereto annexed and the same was also this day by him deposited in the United States mail with first-class postage prepaid, addressed to all counsel of record (other than counsel for the Respondents, who have joined in the foregoing motion), in the consolidated causes in the United States District Court for the Eastern District of Missouri, Eastern Division, entitled **Managed Funds, Incorporated, Plaintiff v. Slayton Associates, Inc., a Corporation** et al., No. 59C 162 (3) and **Emanuel Josephson, Plaintiff, v. Hilton H. Slayton** et al., Defendants, No. 59C 279 (3), as follows:

Lon Hocker and Hocker, Goodwin & MacGreevy, 411 N. Seventh Street, St. Louis 1, Missouri, Attorneys of record for defendants Slayton Associates, Inc., Slayton & Company, Inc., Mutual Fund Distributors, Inc., Hilton H. Slayton and Hovey E. Slayton.

Richmond C. Coburn and Coburn & Croft, 411 No. Seventh Street, St. Louis 1, Missouri, Attorneys of record for defendants Model, Roland & Stone, a co-partnership, and the said named partners.

Cobbs, Armstrong, Teasdale & Roos and William H. Webster, Attorneys of record for defendant Robert Hicks, 506 Olive Street, St. Louis 1, Missouri.

Dubail, Judge & Kilker, 317 North 11th Street, St. Louis 1, Missouri, Attorneys of record for defendant Edwin J. Cunningham.

Lloyd E. Boas, defendant, 901 Washington Avenue, St. Louis 1, Missouri, pro se.

Robert O. Hetlage, 407 North Eighth Street, St. Louis 1, Missouri, Attorney of record for defendant James S. Stubbs.

W. Munro Roberts, Jr., 506 Olive Street, St. Louis 1, Missouri, Attorney of record for defendant Charles E. Brown.

Irving Norris, 800 North American Building, Wilmington, Delaware, Attorney of record for plaintiff Emanuel Josephson.

Benjamin Roth, 611 Olive Street, St. Louis 1, Missouri, Attorney of record for defendant Harold W. Smith.

Biggs, Hensley, Curtis and Biggs and Davis Biggs, 319 North Fourth Street, St. Louis 2, Missouri, Attorneys of record for plaintiff Protective Casualty Insurance Company, Intervenor.

Edward Murphy, 611 Olive Street, St. Louis 1, Missouri, Attorney of record for defendant Stephen M. Jaquith.

Dated this ..... day of ....., 1962.

.....

R. Walston Chubb.

Subscribed and sworn to before me this ..... day of ....., 1962.

.....

Notary Public.

ACKNOWLEDGEMENT OF SERVICE.

Solicitor General.

Receipt is hereby acknowledged this ..... day of ....., 1962 of copy of the foregoing motion to vacate.

.....
Solicitor General,
for Securities and Exchange
Commission, Amicus Curiae.

ACKNOWLEDGEMENT OF SERVICE.

Securities and Exchange Commission.

Receipt is hereby acknowledged this ..... day of ....., 1962 of copy of the foregoing motion to vacate.

.....
General Counsel,
Securities and Exchange
Commission.